ERSTE & STEIERMÄRKISCHE BANK D.D.

ANNUAL REPORT 2007

Content

Report on the performed supervision in the year 2007

Pursuant to Article 263, Paragraph 3 and Article 300c, Paragraph 2 of the Companies Act, and Article 8, Paragraph 1 of the Articles of Association of Erste & Steiermärkische bank d.d. (hereinafter: the Bank), the Supervisory Board of the Bank adopted on February 28, 2008, the following

Report on the performed supervision in the year 2007

I. During 2007, the Supervisory Board fulfilled its activities and made decisions in accordance with its authority as set out by the relevant laws.

The Supervisory Board was regularly informed by the Management Board through written and oral reports regarding the state of the Bank, business policy issues, development plans and the financial results of the Bank.

The activities of the Supervisory Board in 2007 were conducted through meetings, and through Supervisory Board members' written declarations without the convening of a meeting.

During the year 2007, the Supervisory Board held 4 meetings. At these meetings, many of the Bank's outstanding and operational issues were tackled. Pursuant to the provisions of the Articles of Association and the Supervisory Board Rules of Procedure, the Supervisory Board also made decisions without convening a meeting, through Supervisory Board members' written declarations. In this manner, the Supervisory Board made 35 decisions. Decisions made without convening a meeting were made in written form and verified at the next meeting of the Supervisory Board.

The Supervisory Board paid great attention to Management Board Reports on the Bank's operations and gave approval to the Bank Management Board to make decisions and regulations for which Supervisory Board approval is required pursuant to the Banking Act and the Bank's Articles of Association.

The Credit Committee and the Audit Committee helped the Supervisory Board in its work. In 2007, the Credit Committee made 32 decisions in written form, and the Audit Committee held 2 meetings and one decision was reached without convening a meeting. These Committees discussed and made decisions in accordance with their authority and responsibilities as provided for by the Rules on Procedure of the Supervisory Board and the Charter on Audit Committee Work, respectively. The Committees submitted quarterly reports on their work to the Supervisory Board.

II. In accordance with its legal obligations, the Supervisory Board effected the supervision of the Bank's operations and determined that the Bank operates in compliance with the law, the Bank's Articles of Association and other by-laws of the Bank, and the General Meeting's decisions.

III. The Supervisory Board reviewed the Report of the independent auditor Ernst&Young d.o.o., Milana Sachsa 1, 10000 Zagreb, which audited the annual financial statements of the Bank for the year 2007, as well as the consolidated annual financial statements of the Bank's Group, and accepts the Auditor's report without remarks.

The Supervisory Board, having inspected the financial statements of the Bank and the Group submitted by the Bank's Management Board, determined that the annual financial statements of the Bank and the Group for the year 2007 complied with the records in the business books of the Bank and the Group, and accurately presented the assets and operations of the Bank and the Group. Therefore the Supervisory Board granted approval to these statements, whereby, pursuant to Article 300.d of the Company Act, the financial statements are considered to be determined.

The constituent parts of the annual financial statement of the Bank for the year 2007, as well as the financial statements of the Group for the year 2007 are:
a) Profit and loss account
b) Balance sheet
c) Statements of changes in shareholders' equity
d) Cash flow statement
e) Notes to the financial statements.

The Supervisory Board granted approval to the Management Board's Report on the good standing of the Bank.

IV. The Supervisory Board received the Management Board's proposal for the distribution of profit earned in 2007, whereby it was determined that in the year 2007 the Bank realised a net

profit to the amount of HRK 599,029,364.05, which is to be distributed as follows:
- legal reserves, to the amount of HRK 4,897,915.00;
- retained earnings, to the amount of HRK 294,736,246,11;
- shareholders' dividend, to the amount of HRK 299,395,202.94,

so that the shareholders' dividend amounts to 18.58% of the nominal value of a share, or, HRK 18.58 per share.

The Supervisory Board approved the relevant Management Board proposal for the distribution of profit.

V. The Supervisory Board shall submit this report to the General Meeting with a proposal to the General Meeting to accept the Management Board's proposal for the distribution of profit realised in 2007.

Chairman of the Supervisory Board
Johannes Kinsky

Report of the President of the Management Board

I am extremely proud to present you in this Report with the best business results so far of Erste & Steiermärkische Bank d.d. (the Bank), which were achieved during 2007. Although the business environment in the past year was marked by a restrictive monetary policy and limited growth, the Bank continued, even in such difficult conditions, to further strengthen its position as the third bank on the highly competitive Croatian financial market.

Consequently, Bank assets at the end of 2007 amounted to HRK 40.38 billion, which represented an increase of 13.7% compared to the end of 2006. The Bank's market share, measured in terms of the amount of assets at the end of the year, was 12%. At the same time, the accrued net profit of the Bank in 2007 came to HRK 599 million, 48.5% more than the previous year.

The business activities of the Bank in 2007 were marked by two important events on the Croatian financial market. At the beginning of the year, Diners Club Adriatic d.d. became part of the Erste Group, which created better foundations for the further development of credit card business activities. In addition, in the second half of 2007, the Bank together with its partners successfully completed one of the largest and most ambitious projects on the Croatian financial market – the initial public offer of shares in HT Hrvatske telekomunikacije d.d. As one of the agents of the issue, the Bank once again proved its competence in organizing and conducting demanding projects. In the course of September last year, out of a total of 360 thousand people who submitted bids to purchase T-HT shares, 140 thousand did so through Erste & Steiermärkische Bank d.d.

In 2007, the Bank continued its business orientation towards individuals. In addition, the Bank also directed its energies to business with companies, especially small and medium-sized firms. Offering comprehensive financial services to each individual client was one of the main guidelines of business activities. It is my privilege to point out that in the past year we managed, independent of permanent investment in our employees and know-how, to maximally rationalize operation costs and increase efficiency. Thus the ratio between cost and income in the year 2007 amounted to 45%.

In terms of business with individuals, special attention was paid last year to ongoing improvement in the quality of services and an individual approach to clients. According to independent research on the quality of the service of banks conducted by the International Service Check Agency in March 2007, of the eight largest banks in Croatia, Erste Bank achieved the best overall result, while the Zagreb Consultancy Center in Masarykova was declared the best business office. The business network of the Bank was extended to three new branches, in Đakovo, Trogir and Zagreb respectively. In the first half of the year, private banking services were fully implemented, and the Bank paid great attention, through its Small Businesses Division, to this fast growing section of the Croatian Economy.

Trade Sector activities were directed towards the following target segments: activities in tourism, exporting, construction, and entrepreneurs aspiring to receive funds from the European Union. Business co-operation was established with "Hrvatski izvoznici" (The Croatian Exporters Association), and a special product intended for clients engaged in exporting was created, the so-called Erste export package. The growth of loans in the economic sector was largely directed towards the segment of small and medium-sized business clients, though the Bank still remained one of the most active business banks using the lines of the Croatian Bank for Reconstruction and Development.

In the course of 2007, the Bank also paid great attention to the segment of socially accountable business activities. In terms of sponsorship and donations, more than HRK 7 million was provided for cultural, scientific, social, humanitarian and sports projects.

In this area, we would especially like to point out that 2007 saw the fourth edition of the "New Fragments" sponsorship project for young visual artists under 35 years of age.

Our success was first and foremost the result of the effort and hard work of our employees, who numbered 1,723 at the end of 2007 (according to hours spent at work). I would like to take this opportunity to thank them and stress that they will continue to be our strongest guarantee of business success in the future. I would also like to extend my thanks to all our clients and business partners for the trust they have placed in us, because we would not hold the position we do now if it were not for them. I therefore promise that we will do everything in our power in future to remain on top.

Rest assured that in the forthcoming period we will continue our good business results and enter the next year as one of the most successful financial companies on the Croatian market. The guarantee for this is the strategic orientation of the Bank towards innovation, advanced technologies and the training of employees.

Petar Radaković
President of the Management Board

Management Board

PETAR RADAKOVIĆ, Chairman Of The Board

- responsible For Risk Management Division, Property Management Division, Internal Audit Department and Legal Department

TOMISLAV VUIĆ, Deputy Chairman of the Board

- responsible for Retail Division, Multi Channel Management Department, Human Resources Department, Marketing Department and Communication Department

BORISLAV CENTNER, Member of the Board

- responsible for Corporate Division, Treasury Division and Security Custody Department

SLAĐANA JAGAR, Member of the Board

- responsible for Accounting and Controlling Division, Processing Division, IT Division and Organization Department

Retail Banking Division

In 2007, Erste Bank business operations saw two major developments which significantly influenced its retail banking:

- In early April 2007, Diners Club Adriatic d.d. became a member of Erste Group, thereby initiating intensive cooperation between Erste Bank and Diners in credit card business. This has enabled clients to use Diners products and services through Erste Bank's sale channels.
- In September 2007, Erste Bank took part in the initial public offering of T-HT d.d. shares as one of the issuing agents. By number of offers received, this initial public offering of shares was the most comprehensive project of its kind in Croatia, including more than 350,000 offers for purchase of shares, more than 140,000 of which were received at the Erste Bank branch offices.

In addition, and working together with Diners Club Adriatic d.d., the Bank enabled its clients to purchase T-HT shares through loans specially designed for this purpose.

In the second quarter of 2007, the Private Banking Service was officially launched with the aim of providing comprehensive investment service by the Bank and Erste Group, as well as managing clients' assets, in cooperation with a team of highly qualified experts managing fund assets and securities portfolios.

In 2007, cooperation continued with the other members of Erste Group in creating and developing new products and mediating in the sale of these products.
This cooperation, as well as other newly established cooperations in 2007, represent an effort to provide clients with a simple and comprehensive way of dealing with all important financial issues and of realizing their goals.

Network

In 2007, 3 new branch offices were opened, providing comprehensive financial service to clients: in Đakovo, in Trogir and in Vrbani, Zagreb. On December 31, 2007, the network comprised 115 units servicing personal clients, and 8 entrepreneur centres on 29 locations, servicing small businesses.

Successfully realized sales plans

In retail banking, more than 42,500 new clients chose Erste Bank to be their financial business partner in 2007. On December 31, 2007, the total number of clients as individuals surpassed 637,000.

The total number of current accounts grew by 40,400, or 13.20% over the previous year, amounting to 346,795 on December 31, 2007.

The total portfolio in retail loans increased by 16.8% against December 31, 2006. On December 31, 2007, it amounted to HRK 13.37 billion. In the loan portfolio, small businesses grew by 21.5% against December 31, 2006.

On December 31, 2007, in comparison with December 31, 2006, the growth in retail loans was 15.7%. According to this data, the Erste Bank market share in retail loans in this period was 11.8%.

The growth in housing loans on December 31, 2007, against December 31, 2006, was 17.0%, with a housing loan market share of 9.5%.

In 2007, just like the year before, Erste Bank increased the number of deposits faster than the rest of the market with an annual growth of 16.9%, increasing the Bank's market share to 12.0% on December 31, 2007.

The retail deposit balance in 2007 grew by HRK 2.06 billion, amounting to HRK 15.7 billion on December 31, 2007.

New products in 2007

In 2007, new savings products were launched: Erste plan+, the children's savings Medo Štedo, as well as the Visa Business Revolving credit card and the Entrepreneurs' Loan for small businesses.

Erste plan+ is a new savings product on the Croatian market, developed in a cooperation of Erste-Invest and Erste Bank. It was presented to clients in July 2007. The product combines classic saving at the Bank with investment in an investment fund, thereby providing all the advantages of both types of investment. By selecting the type of saving and the investment fund, the client can create his/her own small investment portfolio in a secure environment – and a possibility of higher return by saving at the Bank – by investing in an investment fund.

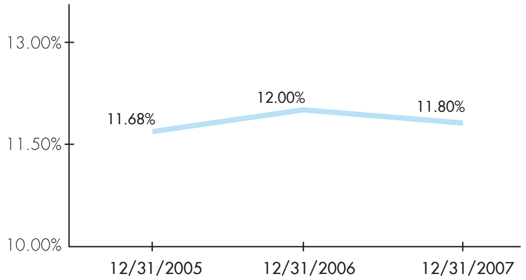
In July 2007, Erste Bank introduced a new savings product – the children's savings Medo Štedo, intended for parents and their children. Children's savings Medo Štedo features all the characteristics of the well-known and successful Active Savings model – clients are able to save through successive payments, according to their own abilities and at their own chosen rhythm. They also profit from an attractive bonus per interest rate total.

During 2007, the Bank has launched four tranches of the Erste Profit+ savings-investment product, enabling our clients to invest safely with a guaranteed principal and the potential of higher return related to the movement of NTX Index shares.

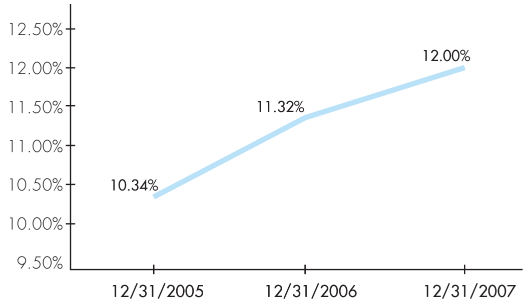
Small businesses can now opt for a new card product: the Visa Business Revolving Card. Functional, offering flexible limits and an adjusted payment system, it satisfies the daily business requirements of small businesses.

In late 2007, in cooperation with Diners Club Adriatic d.d., the Bank expanded its product offer for small businesses through the "Entrepreneurs' Loan", based on the Diners Club Business Card, with the purpose of financing working and permanent working capital.

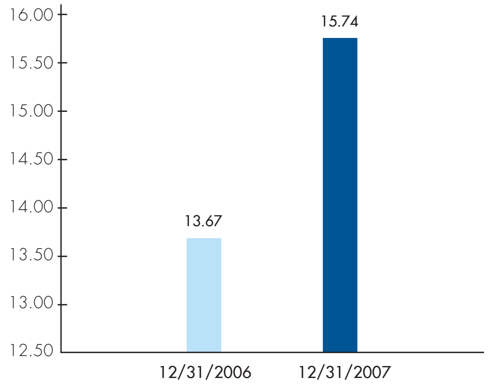
Retail loans - market share



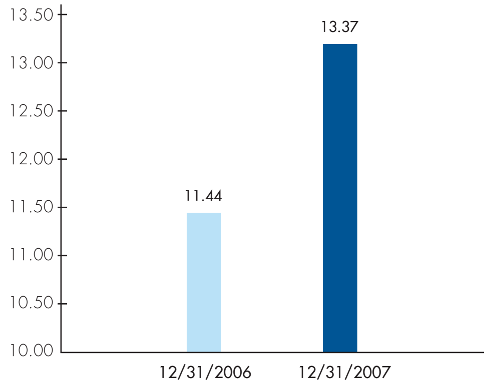
Retail deposits - market share



ESB Deposits in retail - in HRK bil



ESB Loans in retail - in HRK bil



Corporate Division

The restrictive measures of the Croatian National Bank in 2007 continued to have a strong impact on Corporate Division operations, targets and potential growth. Due to an inability to rely on foreign resources, there was a fierce struggle on the market for corporate deposits throughout the year.

Results for sales of Erste Group products outperformed the plan for 2007. Cooperation with Erste Faktoring d.o.o., Erste & Steiermärkische S-Leasing d.o.o., S Immorent Leasing, Erste invest d.o.o. and Erste nekretnine d.o.o. was also intensified. At the beginning of April 2007, Erste Bank der Oesterreichischen Sparkassen AG finished its takeover of 100% of the shares of the Croatian company Diners Club Adriatic d.d., one of the leading credit card companies in Croatia. Cooperation between Diners and the Corporate Division in the area of business card sales was initiated.

Given that construction, tourism and the export industry were identified as target segments of the Division, activities during the year where directed mostly towards these areas.

The Division continued to strategically focus on small and medium-sized companies in general, which meant that Erste was one of the most active Croatian banks in financing with facilities provided by the Croatian Bank for Reconstruction and Development. On the 31 December 2007, CBRD loans amounted to HRK 1.275 million, which was an increase of 22% compared to 31 December 2006. Of the total amount of CBRD loans granted, 42% were related to export and export preparing activities.

The "Incentive to success" programme, created in cooperation with the Ministry of Tourism, allowed Erste & Steiermärkische Bank d.d. to grant 29.23% of the total financing placed and loans granted out of 22 banks participating in the programme.

Since the beginning of the programme, Erste bank placed 122 loans worth a total amount of over HRK 400 million.

At the beginning of 2007, with the final seminar "Small and Family Hotels" in Zagreb, the project, which began in 2006, was successfully completed. The seminar was held in cooperation with the Ministry of Tourism and the Small Family Hotels Association.

ESB financed 20% of the projects which were successful following the SAPARD call for proposals in 2007. Erste Bank was also the only commercial bank which designed a special credit line for SAPARD. As co-organiser with the Croatian Association of Employers and the Ministry of Agriculture, it participated in 4 regional SAPARD conferences. At the beginning of 2007, Erste bank signed a cooperation agreement with the Croatian Association of Employers in the area of EU funds utilisation.

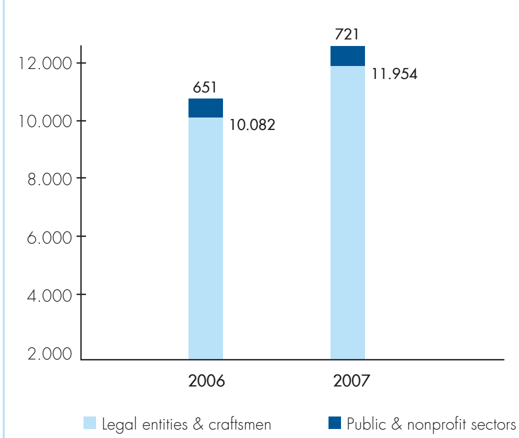
The range of financial products for corporate customers in 2007 was augmented by a new product – Erste Export Package. The package enables clients to take advantage of various benefits stemming from the cooperation agreement between the Bank and the Association of Croatian Exporters, which along with a number of authorities, is active in export promotion and development.

At the end of the year, the Corporate Division employed 184 employees, 12 more than at the end of 2006.

Loans

The total gross loan portfolio of the Corporate Division grew in 2007 by 17.35%. The total corporate loans market share rose from 11.9% (31.12.2006) to 12.9% (31.12.2007).

Gross loan portfolio of the Corporate Division in HRK mil



Most of the lending growth in the year 2007 was carried out with small and medium-sized clients, with whom 66% of the total placed amount was placed.

The rating distribution of the corporate portfolio on 31 December 2007 improved compared to the previous year.

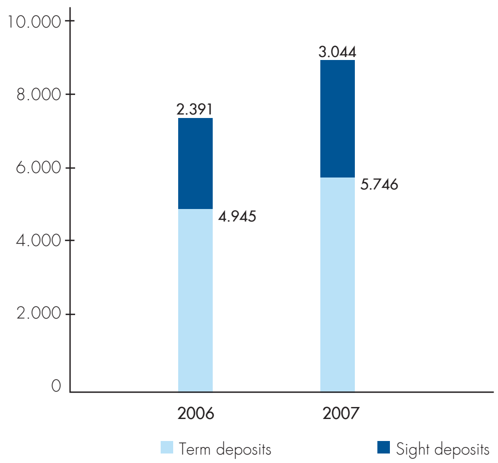
Compared with the situation at the beginning of the year, the industry distribution of the portfolio on 31 December 2007 displays an increased exposure to the construction industry as well as the tourism sector. Overall, industry exposure remained in line with the Bank's credit policy.

Deposits

Total corporate deposits went up by 19.81%, with term deposits going up by as much as 16.2%. Demand deposits went up by 27.31% in the period between 31 December 2006 and 31 December 2007.

However, the market share of corporate deposits fell from 14.3% to 13.6% in the period between 31 December 2006 and 31 December 2007.

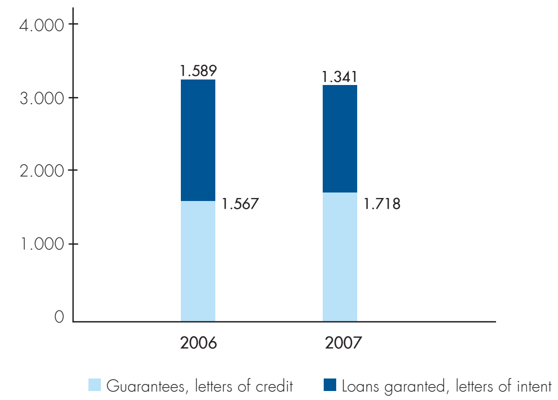
Corporate Division deposits in HRK mil



Off-balance sheet items

Total off-balance sheet items fell by 3%, while letters of credit and guarantees recorded an increase of 10%.

Off-balance sheet items in the Corporate Division in HRK mil



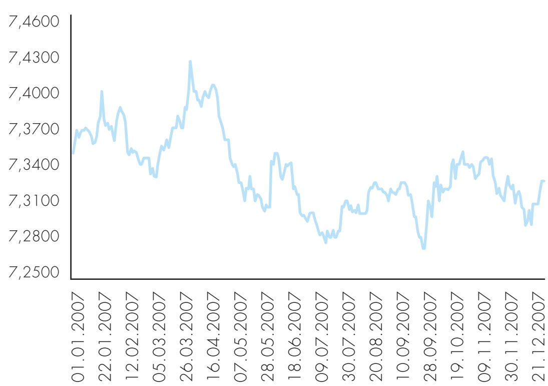
Treasury

The Treasury Division makes deals on the domestic and international money market, capital markets, and is responsible for operational liquidity management and the management of the Bank FX risk.

FX market

The EUR/HRK exchange rate moved in 2007 within the narrow range from 7.27 to 7.42, thus fully accomplishing the goal of the Croatian National Bank regarding the exchange rate stability.

Middle rate EUR/HRK



The beginning of 2007 was characterized by kuna depreciation against the euro due to an increased demand for euro to cover the country external debt. Kuna exchange rate depreciated to the level of 7.42. With the tourism season drawing near and capital increases in banks increased the pressure for the kuna to appreciate. In order to ease that pressure on kuna, the Croatian National Bank intervened for the first time in the summer 2007 by purchasing from the commercial banks at two auctions the total of EUR 139.0 million. The pressure for kuna appreciation continued into the autumn primarily due to the T-HT initial public offering. In order to maintain the necessary level of kuna liquidity, the central bank intervened on the forex market purchasing EUR 355.2 million in total from commercial banks at an auction held at the beginning of October. By the end of year EUR/HRK exchange rate was very stable, at about 7.33.

Forex and Cash Trading Office was reorganized in 2007 by merger of two former offices, Forex Trading Office and Cash Trading Office. This brought trading in foreign currencies and cash under one roof.

In 2007 Forex and Cash Trading Office efficiently managed the foreign exchange position of the Bank, and its activities enabled compliance with the regulation pertaining to bank exposure to currency risk.

Money market

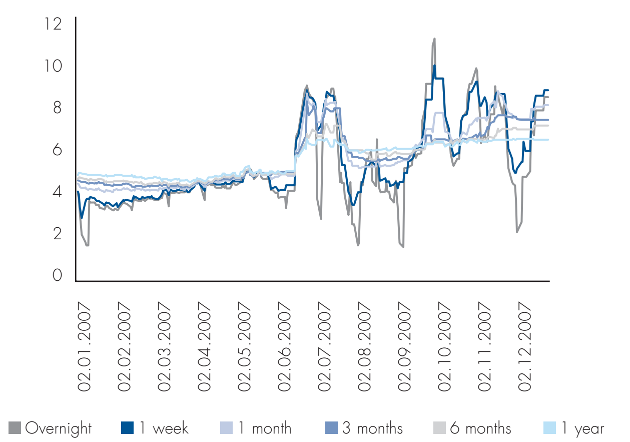
Kuna money market in 2007 was marked by growing interest rates and high volatility. The first half of the year saw stable interest rates which grew by the middle of the year and remained at high levels until the end of the year. Average ZIBOR O/N interest rate was 5.18% in 2007.

CNB actively participated on the money market in 2007 and held 49 reverse repo auctions in total. The total cash placed to banks amounted to HRK 164.4 billion, with the total of HRK 20.3 billion of turned-down offers. The marginal interest rate at the reverse repo auctions at which CNB placed kunas to the banks in the first half of the year was 3.5%. In the same period all bank offers were accepted. By the middle of the year, CNB started increasing the marginal interest rate, placing only targeted amounts of kuna liquidity into the system, and started turning down a part of bank offers. At the end of 2007 the marginal interest rate ended up at 4.1%.

Throughout 2007, a CNB decision limiting the credit growth of banks to 12% per year was in force. Due to a growth above the limit, banks had to subscribe to mandatory treasury bills in the total amount of 2 billion kuna in 2007.

Yield on the treasury bills of the Ministry of Finance followed the interest rate growth on the money market and increased in 2007 for all maturity dates. Return on 91 day maturity in 2007 grew by 5bps to 3.60%, on 182 day maturity by 10bps to 3.75%, while the return on 364 day maturity grew by 120bps to 5.10%. The total of treasury bills issued by the Ministry of Finance issued on primary auctions in 2007 was 13 billion kuna.

ZIBOR



The money market unit was able to efficiently manage the Bank's liquidity throughout 2007. Its activities enabled the Bank at any time to meet any request of its depositors and to simultaneously comply with the regulations: mandatory reserves, marginal reserves, and the minimum required ration of foreign currency claims and liabilities.

Capital market

The year 2007 was marked by significant changes on the global and local market. A significant decline of the real estate market in the USA lead to a credit crisis, which first manifested itself on the US sub-prime mortgage market and then spread to the global financial market, causing large potential write-downs of credit product value in the entire financial industry. As a result, credit spreads reacted by a huge risk revaluation of all property classes against the respective reference yield.

Croatian bond market was not spared of the global trends. Liquidity decline and revaluation of credit risks first affected bonds with a foreign currency clause. German reference bond spreads grew from 30 to 40 bps at the beginning of the year and from 150 to 160 bps at the end of the year. The spread was additionally hit by another issue of foreign currency clause bond tranche amounting to EUR 300 million maturing in 2019.

Croatian euro bonds hit the historical bottom for the German reference bond spreads in May 2007 (20bps), but the credit crunch also triggered a sale of Government lower-rating bonds, and the spread significantly expanded on two occasions and ended up 1% above the lowest levels of June 2007.

Croatian equity market experienced a year of tremendous growth and the largest IPO of Croatian Telecom that aroused an unprecedented interest of citizens and 300 thousand new investors in the stock market, in which process Erste & Steiermärkische Bank acted as an agent.

The Bank participated in all three government bond issues in 2007 as joint lead arranger and underwriter. ESB's portion of government bonds amounted HRK 990 million and EUR 60,75 million, which places ESB among 4 largest government bond arrangers in local market with a 18,64% market share.

The Bank also arranged corporate bonds in amount of HRK 170 million, commercial papers in total amount of HRK 210 million in the domestic market as well as three tranches of commercial papers in the euro-market totaling EUR 40 million.

IT Division and Organization Department

Throughout 2007, the Bank continued processes towards the reorganization of operations and functions in the areas of IT and Organization department, and their harmonization with the structures and processes in place in Erste Group.

Pursuant to EBG directives, the System Support Department spun off from the Bank and IT Division into a separate daughter company registered as IT Services d.o.o. The Bank has established contractual co-operation with the company based on a series of Service Level Agreements.

The Organization Department underwent reorganization, the purpose of which was to set up an organization of work harmonized with the structure of EB Holding. Two new services were established, so that the Department now comprises three services: the Business Organization Service, IT Organization Service, and IT Security Service.

The NORGIT project, started in the year 2006, was successfully brought to an end, thus migrating Erste banka a.d. Novi Sad from Serbia to the IT system of Erste & Steiermärkische Bank d.d. Rijeka.

2007 marked the end of implementation activities connected to an improved Change Request Management. The number of solved Change Requests in 2007 was 379 (252 for Erste & Steiermärkische Bank d.d. Rijeka and 127 for Erste banka a.d. Novi Sad).

The THT IPO project, launched in the first quarter of 2007, was one of the most important projects in the Organization Department and IT Division. IT solutions were developed to support the project, which proved the Bank's ability as a successful implementer of demanding projects at the national level.

An application for the performance management system (SUC) was developed, and at the end of the year the ISMS (Information Security Management Systems) project was launched. Establishing an integrated information security management system will allow timely recognition of information security risks and their appropriate treatment. It will be implemented in line with the international standard ISO 27001/ISO27002 and the best international practices and guidelines.

The IT Division permanently strives to improve system internal design with the aim of increasing the level of automation and reducing processing time, and optimizing the use of machines. It also actively participates in the Erste Group projects: BASEL II, Group Performance Model, Retail 2008, Business Intelligence and Group Payments Initiative, which align operations groupwide in the areas of risk management, controlling, retail banking services, and international payments and money transfers. In addition, the Division provides full IT support to the subsidiary companies of the Erste Group in Croatia.

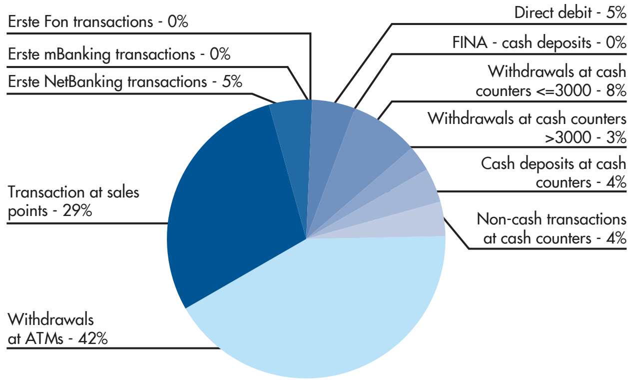
The Organization Department continuously improves the internal working organization, integrality, efficiency, quick response to business needs at low costs of developing and maintaining the entire system, and tries to co-ordinate information security with the bank's business processes. In the category of local projects, we should point out the Treasury project (the part referring to Back office), the Collections project, IP contact center, and DinGo. Apart from the above, the Organization Department was an active participant at groupwide projects, such as: Basel II, GPM, NGA Payments, and NGA BI.

Multi Channel Management Department

In 2007, the Multi Channel Management Department expanded the Bank's range of services with the introduction of new products. These were the Visa Business Revolving Credit Card, which is based on the latest chip technology and is designed for companies located in Croatia, and the Business-to-business Card (B2B), which is a distribution card which is designed for use in the wholesale trade. This card replaces classical models of payment. T-HT's IPO, an important part of the banks' business in 2007, was also important for the electronic banking department, since it was possible to submit a bid and pay for it via Erste NetBanking.

The end of the year saw the Multicash project, which was ready for use. Electronic banking services were also expanded with the possibility of insights into the share ownership of Erste-invest funds, and the possibility of submitting requests for credit cards (which makes Erste bank the first bank in Croatia to make this possible). In addition, the NetPay service for retail, which is an alternative to virtual POS, was introduced. NetPay enables paying in Internet shops via Erste NetBanking. The Call Centre has changed its name to Contact Centre, and has introduced a new working time 24*7. The Contact Centre also took care of all phone calls directed to the Bank's central telephone office and a migration project to the IP technological platform has been initiated.

Number of retail client transactions by distribution channel



During 2007, we upgraded 80 ATMs with EMV, replaced 98, and installed 80 new ones in new locations. As at 30.09.2007, all ATMs were 100% EMV.

Erste & Steiermärkische Bank has 78,937 credit-card users and 580,700 debit-card users, 94,586 SMS users, 11,256 telephone-banking users, 64,848 NetBanking users, and 9,827 mBanking users.

Distribution Channels comprise 415 ATMs, 5,231 POS terminals, 56 DNT devices, SMS services (Erste SMS), Internet (Erste NetBanking), mobile (Erste mBanking) and telephone (ErsteFon) banking.

On average, 13,476 visitors per day visited the Bank's Internet pages www.erstebank.hr, which is a growth of 30% compared to the previous year. Visitors opened 37,822,913 pages and clicked 147,302,266 times on pages opened Internet pages enable visitors to carry out transactions, make calculations, give orders to the bank, and download the "DOH" tax return form.

In 2007, the Contact centre registered 267,063 incoming calls, which is an increase of 12.99% on the previous year.

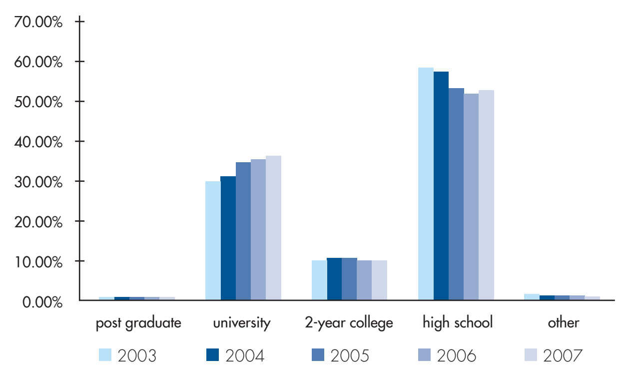
Human Resources

Employees

In 2007, the Bank had 1,723 FTEs and the Group 1,827 FTEs, while the HR Department counted 11 ,10 FTEs (excluding salary calculation).

The educational structure shows a continuation in the tendency of increasing the number of employees with higher education and a decrease in the number of employees with a high school diploma.

Educational structure



The average age is 38, the same as since 2004.

Recruitment

In the period from 1 January to 31 December, we employed 224 members of staff, while 165 finished their employment with the Bank. The voluntary fluctuation rate amounted to 3.48% (compared to 1.99 in 2006). The figure includes transfers to the Group in Croatia.

In the recruitment process, we focus on the internal job market, which has definitely shown itself to be a good tool and an opportunity for promotion and pursuing lateral career paths.

At the end of the year, we implemented a new recruitment software which will enable the web-based collection and processing of all applications. We hope this will result in a quicker and higher quality service to our internal clients.

Training & Development

The basic programmes related to training and development in 2007 were related to the redesign and improvement of internal and external training programmes, the continuation of the Management Development Programme started in 2006, and the roll out of 3 talent programmes at both local and group levels.

Performance Management System

The year 2007 was the first year of the implementation of the new Performance Management System (PMS), designed in the second half of 2006. The System manages performance by cascading goals from Management to all organizational units and positions within the Bank, thus relating individual results with the success of the company, and is directly linked to bonus payments.

This System applies to every position in the Bank, and the tool that manages the system is an internally designed software, situated on the intranet and available to all employees, depending on their level of usage.

Succession planning

We identified the first group of potential candidates for second line management in the succession planning programme. This group will participate in the group and individual training & development programme during 2008 and 2009 in order to be prepared to assume possible future responsibilities.

Other activities

A new Collective Agreement was signed in December 2007, and is valid for 3 years.

In April, we participated in the fifth Careers Day, where we presented the Bank, its recruitment process and possibilities of employment.

The selection of candidates and participation in the new Danubia programme are now a tradition, and which again had success in 2007. The Danubia summer school lasts for four weeks and gathers students from Vienna, Prague, Bratislava, Budapest, Belgrade and Zagreb. They have lectures in each city lasting for a couple of days and, among other activities, visit Erste bank in each country.

Responsibility for the financial statements

Pursuant to the Croatian Accounting Law, the Management Board is responsible for ensuring that financial statements are prepared for each financial year in accordance with International Financial Reporting Standards ('IFRS') as published by the International Accounting Standards Board which give a true and fair view of the state of affairs and results of Erste & Steiermärkische Bank d.d. (the 'Bank') and its subsidiaries (the 'Group') for that period.

After making enquiries, the Management Board has a reasonable expectation that the Group and the Bank have adequate resources to continue in operational existence for the foreseeable future. For this reason, the Management Board continues to adopt the going concern basis in preparing the financial statements.

In preparing those financial statements, the responsibilities of the Management Board include ensuring that:
- suitable accounting policies are selected and then applied consistently;
- judgments and estimates are reasonable and prudent;
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group and the Bank will continue in business.

The Management Board is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Group and the Bank and must also ensure that the financial statements comply with the Croatian Accounting Law. The Management Board is also responsible for safeguarding the assets of the Group and the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed on behalf of the Management Board

Petar Radaković

Slađana Jagar

Erste & Steiermärkische Bank d.d.
Jadranski trg 3a
51 000 Rijeka
Republic of Croatia

24 January 2008

Independent auditors' report

Ernst & Young d.o.o.
Milana Sachsa 1
10 000 Zagreb
Croatia

To the Shareholders of Erste & Steiermärkische Bank d.d.

We have audited the accompanying consolidated and separate financial statements ("the financial statements" of Erste & Steiermärkische Bank d.d. (the "Bank") and its subsidiaries (together, the "Group") which comprise Consolidated and Separate balance sheet as at 31 December 2006 and Consolidated and Separate income statement, Consolidated and Separate statement of changes of equity and Consolidated and Separate cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes (as set out on pages 26 to 91). The financial statements of the Bank and the Group for the year ended 31 December 2006 were audited by other auditors who have, in their report dated 24 January 2007, expressed an unqualified opinion on those financial statements.

Management Responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risk of material misstatement of the financial statements, whether due to the fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide the basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material aspects, the financial position of the Bank and of the Group as at 31 December 2007 and of the results of their operations, cash flows and changes in equity for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young d.o.o.

Ernst & Young d.o.o.

Zagreb, 24 January 2008

Income Statement

FOR THE YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

	Notes	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Interest income	3	2,312	1,771	2,304	1,768
Interest expense	4	(1,224)	(876)	(1,217)	(874)
Net interest income		**1,088**	**895**	**1,087**	**894**
Fee and commission income	5	464	329	421	325
Fee and commission expense	6	(101)	(112)	(120)	(113)
Net fee and commission income		**363**	**217**	**301**	**212**
Net trading income	7	232	121	232	120
Other operating income	8	28	51	28	51
Operating income		**1,711**	**1,284**	**1,648**	**1,277**
Personnel expenses	9	(385)	(324)	(358)	(322)
Other operating expenses	10	(326)	(261)	(306)	(257)
Depreciation of tangible fixed assets	24	(75)	(76)	(69)	(75)
Amortization of intangible fixed assets	25	(17)	(10)	(8)	(9)
Operating Expense		**(803)**	**(671)**	**(741)**	**(663)**
PROFIT BEFORE PROVISION FOR IMPAIRMENT LOSSES, SHARE OF RESULTS OF ASSOCIATES AND INCOME TAX		**908**	**613**	**907**	**614**
Provision for impairment losses on loans and advances	11	(161)	(94)	(161)	(94)
Provision for impairment losses on financial investments	12	4	(5)	4	(5)
Other provisions	31	4	(9)	4	(9)
PROVISION FOR LOAN AND FINANCIAL INVESTMENT LOSSES AND OTHER PROVISIONS		**(153)**	**(108)**	**(153)**	**(108)**
Share of profit of associates	**23**	**4**	**8**	**-**	**-**
PROFIT BEFORE INCOME TAX		**759**	**513**	**754**	**506**
Income taxes	13	(156)	(103)	(155)	(103)
NET PROFIT FOR THE PERIOD		**603**	**410**	**599**	**403**
Attributable to:					
Equity holders of the Bank		**603**	**410**		
Minority interests		**-**	**-**		
EARNINGS PER SHARE					
Basic and diluted (HRK)	35	**38.57**	**29.25**	**38.32**	**28.77**

The accompanying notes form an integral part of these financial statements.

Balance sheet

AS AT 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

	Notes	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
ASSETS					
Cash and balances with the Croatian National Bank	14	6,294	6,348	6,294	6,347
Amounts due from other banks	15	5,444	4,295	5,245	4,143
Reverse repurchase agreements	16	81	132	81	132
Receivables on financial derivative transactions	17	67	33	67	33
Financial assets held for trading	18	538	178	530	168
Financial assets at fair value through profit or loss	18	20	-	20	-
Loans and advances to customers	19	25,652	21,775	25,651	21,775
Financial investments available for sale	20	1,315	1,603	1,315	1,603
Financial investments held to maturity	21	464	566	464	566
Non-current assets held for sale	22	-	24	-	23
Investments in subsidiaries and associates	23	28	22	46	44
Property and equipment	24	528	571	510	550
Intangible assets	25	36	34	33	25
Deferred tax assets	13	46	36	46	36
Other assets	26	77	70	76	69
Total assets		**40,590**	**35,687**	**40,378**	**35,514**
LIABILITIES					
Amounts due to other banks	27	2,494	2,370	2,494	2,370
Repurchase agreements	16	289	-	289	-
Payables on financial derivative transactions	17	60	20	60	20
Financial liabilities held for trading	18	7	-	7	-
Financial liabilities at fair value through profit or loss	18	20	-	20	-
Amounts due to customers	28	25,919	22,130	25,929	22,131
Other borrowed funds	29	7,355	7,175	7,163	7,027
Current tax liabilities	13	63	33	62	32
Deferred tax liabilities	13	2	-	2	-
Other liabilities	30	362	340	356	334
Provisions	31	68	71	68	71
Subordinated debt	32	-	704	-	704
Total liabilities		**36,639**	**32,843**	**36,450**	**32,689**

Balance sheet

AS AT 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

	Notes	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Shareholders' equity					
Share capital	33	1,611	1,513	1,611	1,513
Share premium	33	1,164	568	1,164	568
Retained earnings	34	951	627	940	620
Available for sale reserves		6	(6)	6	(6)
Other capital reserves	34	207	130	207	130
Equity attributable to equity holders of the Bank		3,939	2,832	3,928	2,825
Minority interest		12	12	-	-
Total equity		3,951	2,844	3,928	2,825
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		40,590	35,687	40,378	35,514
FINANCIAL COMMITMENTS AND CONTINGENCIES	41	4,092	4,181	4,092	4,181

The accompanying notes form an integral part of these financial statements.

Signed on behalf of Erste & Steiermärkische Bank d.d. on 24 January 2008:

President of the Management Board
Petar Radaković

Member of the Management Board
Slađana Jagar

Consolidated Statement of changes in shareholders' equity

FOR THE YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

GROUP	Attributable to the equity holders of the Bank							
	Share capital	Share premium	Retained earnings	Available for sale reserves	Statutory and legal reserves	Total	Minority interest	Total equity
Balance as at 1 January 2006	**1,324**	**-**	**349**	**-**	**102**	**1,775**	**-**	**1,775**
Changes in equity for 2006								
Loss on assets available for sale	-	-	-	(7)	-	(7)	-	(7)
Related income tax	-	-	-	1	-	1	-	1
Net expense recognized directly in equity	**-**	**-**	**-**	**(6)**	**-**	**(6)**	**-**	**(6)**
Net profit for the period	-	-	410	-	-	410	-	410
Total recognized income and expense for the period	**-**	**-**	**410**	**(6)**	**-**	**404**	**-**	**404**
Share capital increase	189	568	-	-		757		757
Distribution of income for 2005:								
Transfer to reserves	-	-	(28)	-	28	-	-	-
Dividends	-	-	(104)	-	-	(104)	-	(104)
Acquisition of subsidiaries	-	-	-	-	-	-	12	12
Balance as at 31 December 2006	**1,513**	**568**	**627**	**(6)**	**130**	**2,832**	**12**	**2,844**
Changes in equity for 2007								
Gains on assets available for sale	-	-	-	15	-	15	-	15
Related income tax	-	-	-	(3)	-	(3)	-	(3)
Net income recognized directly in equity	**-**	**-**	**-**	**12**	**-**	**12**	**-**	**12**
Net profit for the period	-	-	603	-	-	603	-	603
Total recognized income for the period	**-**	**-**	**603**	**12**	**-**	**615**	**-**	**615**
Share capital increase	98	596	-	-	-	694	-	694
Distribution of income for 2006:								
Transfer to reserves	-	-	(77)	-	77	-	-	-
Dividends	-	-	(202)	-	-	(202)	-	(202)
Balance as at 31 December 2007	**1,611**	**1,164**	**951**	**6**	**207**	**3,939**	**12**	**3,951**

The accompanying notes form an integral part of these financial statements.

Statements of changes in shareholders' equity

FOR THE YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

BANK	Share capital	Share premium	Retained earnings	Available for sale reserves	Statutory and legal reserves	Total equity
Balance as at 1 January 2006	1,324	-	349	-	102	1,775
Changes in equity for 2006						
Loss on assets available for sale	-	-	-	(7)	-	(7)
Related income tax	-	-	-	1	-	1
Net expense recognized directly in equity	-	-	-	(6)	-	(6)
Net profit for the period	-	-	403	-	-	403
Total recognized income and expense for the period	-	-	403	(6)	-	397
Share capital increase	189	568	-	-	-	757
Distribution of income for 2005:						
Transfer to reserves	-	-	(28)	-	28	-
Dividends	-	-	(104)	-	-	(104)
Balance as at 31 December 2006	1,513	568	620	(6)	130	2,825
Changes in equity for 2007						
Gains on assets available for sale	-	-	-	15	-	15
Related income tax	-	-	-	(3)	-	(3)
Net income recognized directly in equity	-	-	-	12	-	12
Net profit for the period	-	-	599	-	-	599
Total recognized income for the period	-	-	599	12	-	611
Share capital increase	98	596	-	-	-	694
Distribution of income for 2006:						
Transfer to reserves	-	-	(77)	-	77	-
Dividends	-	-	(202)	-	-	(202)
Balance as at 31 December 2007	1,611	1,164	940	6	207	3,928

The accompanying notes form an integral part of these financial statements.

Cash flow statement

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

	Notes	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Operating Activities					
Loss from operating activities before changes in operating assets and liabilities	38	*(101)*	*(218)*	*(115)*	*(218)*
Changes in operating assets and liabilities:					
Obligatory reserves with the Croatian National Bank		10	(393)	10	(393)
Amounts due from other banks		(14)	(96)	(128)	17
Reverse repurchase agreements		51	(35)	51	(35)
Net (decrease)/increase in financial assets held for trading		(360)	342	(363)	340
Net decrease in assets at fair value through profit and loss		(20)	-	(20)	-
Loans and advances to customers, net of write-offs		(3,972)	(3,585)	(3,971)	(3,587)
Other assets		(8)	6	(8)	(1)
Amounts due to the Croatian National Bank		-	(608)	-	(608)
Amounts due to other banks		132	(296)	132	(438)
Repurchase agreements		289	-	289	-
Financial liabilities held for trading		7	-	7	-
Financial liabilities at fair value through profit or loss		20	-	20	-
Amounts due to customers		3,898	5,095	3,863	5,095
Other liabilities		23	51	23	51
Cash (used in)/from operations		*(45)*	*263*	*(210)*	*223*
Interest paid		(1,168)	(787)	(1,160)	(787)
Interest received		2,261	1,755	2,251	1,756
Income taxes paid		(136)	(169)	(135)	(170)
NET CASH PROVIDED BY OPERATING ACTIVITIES		**912**	**1,062**	**746**	**1,022**
Investing Activities					
Acquisition of subsidiaries		-	(3)	-	(6)
Purchase of property and equipment		(86)	(130)	(80)	(134)
Disposals of property and equipment		54	65	51	65
Purchase of intangible assets		(32)	(28)	(30)	(18)
Disposals of intangible assets		13	8	13	8
Purchase of investments available for sale		251	(107)	251	(107)
Increase in investments in associates		(2)	(4)	(2)	(4)
Sales of investments in associates		23	-	23	-
Redemption of investments held to maturity		105	(83)	105	(83)
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES		**326**	**(282)**	**331**	**(279)**

Cash flow statement

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

	Notes	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Financing Activities					
Subordinated borrowings		(698)	(12)	(698)	(12)
Share capital increase		98	189	98	189
Share premium increase		596	568	596	568
Dividends paid		(202)	(104)	(202)	(104)
NET CASH (USED IN)/PROVIDED BY FINANCING ACTIVITIES		(206)	641	(206)	641
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,032	1,421	871	1,384
CASH AND CASH EQUIVALENTS AT 1 JANUARY	38	6,121	4,700	6,083	4,699
CASH AND CASH EQUIVALENTS AT 31 DECEMBER	38	7,153	6,121	6,954	6,083

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

1. GENERAL

History and incorporation

Erste & Steiermärkische Bank d.d. (the 'Bank') was established in 1954 and was entered into the Court Register as a joint stock company on 24th January 1990. The Bank's registered head office is at Jadranski trg 3a, Rijeka, the Republic of Croatia.

Principal activities of the Bank

The Bank is licensed to conduct commercial banking activities in the Republic of Croatia. The Bank's main operations are as follows:

- accepting deposits from clients and the placing of deposits;
- granting loans, issuing guarantees and letters of credit to the individuals, companies, public and other clients,
- treasury operations in the interbank market,
- trust management and investment banking services,
- performing domestic and international payments,
- providing banking services through an extensive branch network in the Republic of Croatia.

Supervisory Board

Johannes Kinsky	President since 29th of June 2007
Mag. Reinhard Ortner	President until 29th of June 2007
Mag. Franz Kerber	Deputy President
Péter Kisbenedek	Member since 29th of June 2007
Mag. Gerhard Maier	Member
Mag. Peter Nemschak	Member
Dr. Kristijan Schellander	Member
Mag. Peter Weiss	Member since 29th of June 2007
Claudia Hoeller	Member until 29th of June 2007
Herbert Juranek	Member until 29th of June 2007
Andreas Klingen	Member until 29th of June 2007
Mag. Helmut Payer	Member until 29th of June 2007

Management Board

The Bank is represented jointly by two members of the Management Board, or by one member of the Management Board together with the procurator.

Petar Radaković	President
Tomislav Vuić	Deputy President
Borislav Centner	Member
Slađana Jagar	Member

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

1. GENERAL (CONTINUED)

Procurators:

Damir Bronić
Marko Krajina
Zdenko Matak
Ivan Vuk Until 31st of March 2007

The shareholding structure of the Bank is as follows:

	2007		2006	
	Number of shares	Ownership, %	Number of shares	Ownership, %
Erste Bank der österreichischen Sparkassen AG, Wien	8,848,301	54.9%	8,286,192	54.7%
Steiermärkische Bank und Sparkassen AG, Graz	6,604,149	41.0%	6,202,591	41.0%
Member of Management Board - Slađana Jagar	235	0.0%	235	0.0%
Other shareholders	661,158	4.1%	645,242	4.3%
Total	16,113,843	100.0%	15,134,260	100.0%

The Bank's ordinary shares are listed on the Zagreb Stock Exchange as a public stock company.

Definition of the consolidated group

The Bank is a parent company of the banking group (the "Group") which includes the following subsidiaries consolidated in the financial statements:

Name of subsidiary	Ownership interest	Principal activity	Audited by	Registered office
Erste DMD d.o.o. za upravljanje dobrovoljnim mirovinskim fondom	100%	Management company for voluntary pension fund	Ernst & Young d.o.o.	Ivana Lučića 2a, Zagreb
Erste nekretnine d.o.o.	90%	Real estate business	Ernst & Young d.o.o.	Ivana Lučića 2a, Zagreb
MBU d.o.o. za informatički inženjering i međubankarske usluge	55.88%	IT engineering and interbank services	Ernst & Young d.o.o.	Andrije Žaje 61, Zagreb

The Group considers that it operates in a single business segment, and a single geographical segment, that is the provision of banking services in the Republic of Croatia.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1. Basis of presentation

The financial statements are presented for the Group ('consolidated financial statements') and the Bank only ('separate financial statements').

The financial statements are prepared in accordance with International Financial Reporting Standards ('IFRS') as published by the International Accounting Standards Board, under the historical cost convention, as modified by the revaluation of appropriate financial assets and liabilities. The financial statements are presented in millions of Local Currency – Croatian Kuna ('HRK'), unless otherwise indicated.

The financial statements are prepared on an accrual basis of accounting, under the going concern assumption.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. These estimates are based on the information available as at the balance sheet date and actual results could differ from those estimates.

The Bank maintains its books of accounts and prepares financial statements for regulatory purposes in accordance with the regulations of the Croatian National Bank ('CNB'). The accompanying financial statements are based on the accounting records of the Bank and its subsidiaries, together with appropriate adjustments and reclassifications necessary for their fair presentation in accordance with IFRS.

2.2. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities controlled by the Bank (its subsidiaries). Control is achieved where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets (excluding goodwill) of consolidated subsidiaries are identified within equity, separately from the equity attributable to the shareholders of the Bank. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Accounting for investments in subsidiaries in the separate financial statements of the Bank

Investments in subsidiaries are accounted at cost in the separate financial statements of the Bank.

2.3. Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 *Business Combinations* are recognized at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which are recognized and measured at fair value less costs to sell.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Goodwill arising on acquisition is recognized as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized. If the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognized immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognized.

2.4. Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results, assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting, except when the investment is classified as held for sale, in which case it is accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are not recognized, unless the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of the associate recognized at the date of acquisition is recognized as goodwill. The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of the investment. Any excess of the Group's share of the net fair value of identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognized immediately in profit or loss.

Accounting for investments in associates in the separate financial statements of the Bank

Investments in associates are accounted at cost in the separate financial statements of the Bank.

2.5. Goodwill

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary recognized at the date of acquisition. Goodwill is initially recognized as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

2.6. Adoption of new and revised International Financial Reporting Standards

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Group has adopted the following new and amended IFRS and International Financial Reporting Interpretations Committee ('IFRIC') Interpretations during the year. Adoption of these revised standards and Interpretations did not have any effect on the financial performance or position of the Group. They did however give rise to additional disclosures, including in some cases, revisions to accounting policies:

- IFRS 7 *Financial Instruments: Disclosures*
- IAS 1 *Amendment - Presentation of Financial Statements*
- IFRIC 9 *Reassessment of Embedded Derivatives*
- IFRIC 10 *Interim Financial Reporting and Impairment*

Adoption of these standards and Interpretations did not have any effect on the financial performance or position of the Group. They did however give rise to additional disclosures, including revisions to accounting policies.

- IFRS 7 *Financial Instruments: Disclosures* - This standard requires disclosures that enable users of the financial

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included throughout the financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

- IAS 1 *Presentation of Financial Statements* - This amendment requires the Group to make new disclosures to enable users of the financial statements to evaluate the Group's objectives, policies and processes for managing capital. These new disclosures are shown in Note 42.
- IFRIC 9 *Reassessment of Embedded Derivatives* - IFRIC 9 states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. As the Group has previously also reassessed the need for separation only if there is a change to the contract that significantly modifies the cash flows, the Interpretation had no impact on the financial position or performance of the Group.
- IFRIC 10 *Interim Financial Reporting and Impairment* - The Group adopted IFRIC Interpretation 10 as of 1 January 2007, which requires that an entity must not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Group had no impairment losses previously reversed, the Interpretation had no impact on the financial position or performance of the Group.

The Group has not early adopted any of the IFRS and IFRIC Interpretations which will come into effect in the following periods. At the date of authorisation of these financial statements, the following Standards and Interpretations were in issue but not yet effective:

- IAS 23 *Borrowing Costs* - A revised IAS 23 *Borrowing costs* was issued in March 2007, and becomes effective for financial years beginning on or after 1 January 2009. The standard has been revised to require capitalisation of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the Standard, the Group will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.
- IFRIC 12 *Service Concession Arrangements* - IFRIC Interpretation 12 was issued in November 2006 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. No member of the Group is an operator and hence this Interpretation will have no impact on the Group.
- IFRIC 13 *Customer Loyalty Programmes* - IFRIC Interpretation 13 was issued in June 2007 and becomes effective for annual periods beginning on or after 1 July 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Group expects that this Interpretation will have no impact on the Group's financial statements as no such schemes currently exist.
- IFRIC 14 IAS 19 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* - IFRIC Interpretation 14 was issued in July 2007 and becomes effective for annual periods beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 19 Employee Benefits. The Group expects that this Interpretation will have no impact on the financial position or performance of the Group as all defined benefit schemes are currently in deficit.
- IFRIC 11 IFRS 2 *Group and Treasury Share Transactions* - This Interpretation requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

shareholders provide the equity instruments needed. The Group expects that this Interpretation will have no impact on the Group's financial statements as no such schemes currently exist.

- IFRIC 8 *Scope of IFRS 2* - This Interpretation requires IFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As such equity instruments are not issued, the Group expects that this Interpretation will have no impact on the financial position or performance of the Group.

The management anticipate that the adoption of these Standards and Interpretations in future periods will have no material financial impact on the financial statements of the Bank and the Group.

2.7. Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Bank and the Group as lessee

Assets held under finance leases are recognized as assets of the Bank and the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance charges are charged to the income statement. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

2.8. Non-current assets held for sale

Non-current assets are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition.

2.9. Interest Income and Expense

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest income includes coupons earned on fixed income investments and securities and accrued discount and premium on treasury bills and other discounted instruments.

When loans become impaired, they are written down to their recoverable amounts and interest income thereafter recognized based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

2.10. Fee and Commission Income and Expense

Fees and commissions consist mainly of fees on domestic and foreign payments, guarantees, letters of credit, card business and other credit instruments issued by the Bank and the Group. Such fees and commissions are generally recognized as income when due.

Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

2.11. Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax expense is based on taxable income for the year. Taxable income differs from net income as reported in the income statement because it excludes items of income or

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's and the Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realized. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

The Bank and its subsidiaries are subject to various indirect taxes which are included in Other operating expenses.

2.12. Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents include cash, balances with the Croatian National Bank ('CNB'), current accounts with other banks and term placements with other banks with residual maturity up to 3 months, and treasury bills with residual maturity up to 3 months.

Cash and cash equivalents exclude the obligatory reserves with the CNB, as these funds are not available for the Bank's day to day operations. The obligatory reserve with the CNB is a required reserve to be held by all commercial banks licensed in Croatia.

2.13. Financial assets

Financial assets held by the Bank and the Group are categorized into portfolios in accordance with the Bank's and the Group's intent on the acquisition and pursuant to the investment strategy. Financial assets and liabilities are classified as 'At fair value through profit or loss', 'Held to maturity', 'Assets available for sale' or as 'Loans and receivables'. The principal difference among the portfolios relates to the measurement of financial assets and the recognition of their fair values in the financial statements.

All financial assets and liabilities are recognized and derecognized on a settlement date basis where the purchase or sale of a financial asset or liability is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned.

When a financial asset or financial liability is recognized initially, the Bank and the Group measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

a) Assets at fair value through profit or loss

Financial assets are classified as at FVTPL where the financial assets are held for trading.

A financial asset is classified as held for trading if:
- it has been acquired principally for the purpose of selling in the near future; or
- it is a part of an identified portfolio of financial instruments that the Bank and the Group manage together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement:

Subsequent to initial recognition, financial assets at fair value through profit or loss are accounted for and stated at a fair value which approximates the price quoted on recognized stock exchanges or acceptable valuation models. The Bank and the Group include realized and unrealized gains and losses in 'Net trading income'. Interest earned on assets at fair value through profit or loss representing coupons on debt securities is accrued on a daily basis and reported within 'Net trading income' in the Income statement.

Dividends on trading securities are recorded when declared and included as a receivable in the balance sheet line 'Other assets' and in 'Net trading income' in the Income statement.

All purchases and sales of securities held for trading that require delivery within the timeframe established by regulation or market convention ('regular way' purchases and sales) are recognized as spot transactions. Transactions that do not meet the 'regular way' settlement criterion are treated as financial derivatives.

b) Investments held to maturity

Investments held to maturity are non-derivative financial assets with fixed or determinable payments and a fixed maturity that the Bank and the Group have the positive intent and ability to hold to maturity. This portfolio comprises fixed income debt securities. Held to maturity investments are carried at amortized cost using the effective interest rate method, less any allowance for impairment.

The Bank and the Group assess on a regular basis whether there is any objective evidence that an investment held to maturity may be impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount which is equal to the present value of expected future cash flows discounted at the financial instrument's original effective interest rate. The amount of the impairment loss for assets carried at amortized cost is calculated as the difference between the asset's carrying amount and the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. When an impairment of assets is identified, the Bank and the Group recognize allowances through the profit and loss statement line 'Provision for impairment losses on financial investments'.

Impairment losses are reversed in subsequent periods when an increase in the investment's recoverable amount can be related objectively to an event occurring after the impairment was recognized, subject to the restriction that the carrying amount of the investment at the date the impairment is reversed shall not exceed what the amortised cost would have been had the impairment not been recognized.

c) Assets Available for sale

Available for sale financial investments are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held to maturity investments or (c) financial assets at fair value through profit or loss.

This portfolio comprises equity and debt securities. Subsequent to initial recognition, available for sale financial investments are re-measured at fair value based on quoted prices or amounts derived from cash flow models. In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and the fair value of unquoted equity instruments is estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer.

For available for sale investments, gains and losses arising from changes in fair value are recognized directly in equity under the caption 'AfS reserves', until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the profit or loss for the period. Impairment losses recognized in profit or loss for equity investments classified as available for sale are not subsequently reversed through profit or loss. Impairment losses recognized in profit or loss for debt

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

instruments classified as available for sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

Interest earned whilst holding available for sale securities is accrued on a daily basis using the effective interest rate method and reported as "Interest income" in the income statement.

Foreign exchange differences related to available for sale equity instruments held in foreign currency are reported together with fair value gains and losses in equity until the financial asset is sold. Foreign exchange differences related to available for sale debt instruments held in foreign currency are reported in the income statement.

Dividends on securities available for sale are recorded as declared and included as a receivable in the balance sheet line 'Other assets' and in 'Other operating income' in the income statement. Upon payment of the dividend, the receivable is offset against the collected cash.

d) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than (a) those that the Bank and the Group intend to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss; (b) those that the Bank and the Group upon initial recognition designate as available for sale; or (c) those for which the Bank and the Group may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale. This portfolio comprises loans provided to customers.

Loans and receivables are carried at amortized cost using the effective interest method, less any allowance for impairment. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction as well as fees received from customers. Loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

An allowance for loan impairment is established if there is objective evidence that the Bank and the Group will not be able to collect all amounts due. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate of loans computed at initial recognition. Loan loss allowances are assessed with reference to the credit standing and performance of the borrower and take into account the value of any collateral or third party guarantees.

If no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the Bank and the Group include the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

When a loan is uncollectible, it is written off against the related allowance for impairment; subsequent recoveries are credited to the 'Impairment losses on loans and advances' line in the income statement.

Penalty interest is charged to borrowers when a portion of the loan falls overdue. Penalty interest is accounted for on a cash received basis in the caption 'Interest income'.

2.14. Financial liabilities

Financial liabilities of the Bank and the Group such as 'Amounts due to other banks', 'Amounts due to customers', and 'Subordinated debt' are stated at amortized cost using the effective interest rate method. Interest expense arising on the issue of certificated debts is included in the income statement line 'Interest expense'.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.15. Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- the amount of the obligation under the contract, as determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with revenue recognition policies.

2.16. Derivative financial instruments

In the normal course of business the Bank and the Group enter into derivative financial instruments to manage currency, liquidity and interest rate risks and such financial instruments are held primarily for trading purposes. Derivatives entered into by the Bank and the Group include forwards, foreign currency and equity options and futures.

Derivative financial instruments are initially recorded at cost (including transaction costs) and subsequently re-measured at their fair value. Fair values are principally obtained from discounted cash flow models and option pricing models as appropriate. The results of the valuation of derivatives are reported in assets (aggregate of positive fair values) or liabilities (aggregate of negative fair values), respectively. Both positive and negative valuation results are recognized in the profit and loss for the year in which they arise in the income statement line 'Net trading income'.

In case of equity options, when the underlying equity instrument is not publicly traded and its fair value can not be measured reliably, the fair value of the options is not determined and such options are measured in the financial statements at cost.

Certain derivative transactions, while providing effective economic hedges under the Bank's and the Group's risk management positions, do not qualify for hedge accounting under the specific rules of IAS 39 and are therefore treated as derivatives held for trading with fair value gains and losses reported in the income statement line 'Net trading income'.

2.17. Sale and repurchase agreements

If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized as the Bank and the Group retain substantially all the risks and rewards of ownership.

Securities sold under sale and repurchase agreements ('repos') are recorded as assets in the balance sheet according to the original classification or the Bank and the Group reclassify the asset on its balance sheet, as a 'Repurchase receivable' if the transferee obtains the right to sell or pledge the asset. The corresponding liability towards the counterparty is included in 'Repurchase agreements'.

Securities purchased under agreements to purchase and resell ('reverse repos') are recorded as assets in the balance sheet line 'Reverse repurchase agreements', with the corresponding decrease in cash being included in 'Cash and balances with the Croatian National Bank.' The difference between the sale and repurchase price is treated as interest and accrued evenly over the life of the repurchase agreement using the effective interest rate.

2.18. Tangible and intangible fixed assets

Fixed and intangible assets are stated at historical cost less accumulated depreciation. Depreciation is calculated on a straight-line basis to write down the cost of such assets to their residual values over their estimated useful lives. Land and assets in the course of construction are not depreciated.

Estimated economic useful lives are set out below:

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

	2007	2006
Buildings	40 years	40 years
Computers	4 years	4 years
Furniture and equipment	3-10 years	3-10 years
Motor vehicles	4 years	4 years
Software	4 years	4 years
Other intangible assets	5 years	5 years

The carrying amounts of fixed and intangible assets are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amounts, and where carrying values exceed this estimated recoverable amount, assets are written down to their recoverable amount. An impairment is recognized in the respective period and is included in operating expenses. After the recognition of an impairment loss, the depreciation charge for fixed assets is adjusted in future periods to allocate the assets' revised carrying value, less its residual value (if any), on a systematic basis over its remaining useful life.

2.19. Foreign Currency Translation

Transactions denominated in foreign currencies are translated into HRK at the prevailing exchange rates on the date of the transaction.

Monetary items denominated in foreign currencies are retranslated into HRK at the appropriate spot rates of exchange prevailing at the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in profit or loss for the period in 'Net trading income'. Exchange differences arising on the retranslation of non-monetary assets carried at fair value are included in profit or loss for the period except for exchange differences arising on the retranslation of non-monetary assets available for sale in respect of which gains and losses are recognized directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognized directly in equity.

The Bank and the Group have assets and liabilities originated in HRK, which are linked to foreign currency with a one-way currency clause. Due to this clause, the Bank and the Group have an option to revalue the asset by the higher of: the foreign exchange rate valid as of the date of maturity, or the foreign exchange rate valid as of the date of origination of the financial instrument. In case of a liability linked to this clause, the counterparty has this option. Due to the specific conditions of the market in the Republic of Croatia, the fair value of this option cannot be calculated, as the forward rates for HRK for periods over 6 months are not available. As such, the Bank and the Group value their assets and liabilities related to this clause by the agreed contract rate valid at the date of the balance sheet or foreign exchange rate agreed by the option (rate valid at origination), whichever is higher.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The principal rates of exchange set forth by the Croatian National Bank and used in the preparation of the Bank's and the Group's balance sheet at the reporting dates were as follows:

31 December 2007	EUR 1 = HRK 7.325131	USD 1 = HRK 4.985456	CHF 1 = HRK 4,412464
31 December 2006	EUR 1 = HRK 7.345081	USD 1 = HRK 5.578401	CHF 1 = HRK 4,571248

2.20. Off-Balance-Sheet Commitments

In the ordinary course of business, the Bank and the Group enter into credit related commitments which are recorded in off-balance-sheet accounts and primarily include guarantees, letters of credit and undrawn lending commitments. Such financial commitments are recorded in the Bank's and the Group's balance sheet if and when they become payable.

2.21. Provisions

Provisions are recognized when the Bank and the Group have a present obligation as a result of a past event, and it is probable that the Bank and the Group will be required to settle that obligation. The Management Board determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors at the balance sheet date. Provisions are discounted to present value where the effect is material.

2.22. Long-term employee benefits

For defined retirement benefit and jubilees, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognized in full in the period in which they occur. They are recognized outside profit or loss and presented in the statement of changes in equity.

Past service cost is recognized immediately to the extent that the benefits are already vested, and otherwise is amortized on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognized in the balance sheet represents the present value of the defined benefit obligation.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

2.23. Fiduciary activities

Assets and income arising thereon, together with related undertakings to return such assets to customers, are excluded from the financial statements when the Bank and the Group act in a fiduciary capacity such as nominee, trustee or agent.

2.24. Critical accounting judgments and key sources of estimation uncertainty

In the application of accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

While it is possible that in particular periods the Bank and the Group may sustain losses, which are substantial, relative to the allowance for impairment losses, it is the judgment of management that the allowance for impairment losses is adequate to absorb losses incurred on the risk assets.

Due to the absence of recently observed market prices for the derivative financial instruments, the management has decided to measure derivatives using discounted cash flow models. Discount factors used in these models are derived from smooth interest rates and volatility curves constructed with predefined interpolation methods and market interest rates from Reuters which are valid as at 31 December 2007 for each currency and corresponding maturity dates.

In the ordinary course of business, the Bank and the Group are subject to legal actions and complaints. The management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial situation or the results of future operations of the Bank and the Group. As of 31 December 2007 the management established, based on the advice of legal counsel, provisions for these risks amounting to HRK 4 million. For the rest of the legal cases where the Bank or its subsidiaries act as a defendant, no provisions were created as the management, based on the advice of legal counsel, is of the opinion that the Bank's and the subsidiaries' cases will prevail and the probability of an adverse outcome of the litigations is remote.

2.25. Reclassification

Certain reclassifications have been made to the financial statements as at 31 December 2006 and for the year then ended to conform to the presentation as at 31 December 2007 and for the year then ended.

2.26. Regulatory requirements

The Bank is subject to the regulatory requirements of the Croatian National Bank. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off balance sheet commitments and forming allowances to cover credit risk, liquidity, interest rate and foreign currency positions.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

3. INTEREST INCOME

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Interest on loans and advances to customers	1,970	1,551	1,970	1,551
Interest on amounts due from other banks	185	67	177	64
Interest income on financial investments	86	95	86	95
Interest on balances due from the Croatian National Bank	36	28	36	28
Interest income on impaired financial assets				
- loans and advances to customers	29	16	29	16
Interest on reverse repurchase agreements	4	13	4	13
Other interest income	1	1	1	1
	2,311	**1,771**	**2,303**	**1,768**
Interest on financial assets designated at fair value through profit or loss	1	-	1	-
	2,312	**1,771**	**2,304**	**1,768**

4. INTEREST EXPENSE

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Interest on customer deposits	686	531	686	531
Interest on other borrowed funds	368	237	369	237
Interest on amounts due to other banks	140	73	132	71
Interest on subordinated debt	17	29	17	29
Interest on repurchase agreements	12	4	12	4
Other interest expense	-	2	-	2
	1,223	**876**	**1,216**	**874**
Interest on financial liabilities designated at fair value through profit or loss	1	-	1	-
	1,224	**876**	**1,217**	**874**

5. FEE AND COMMISSION INCOME

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Payments and money transfers	201	181	199	179
Bank cards services	139	79	102	77
Portfolio, management, brokerage and other asset management fees	68	27	69	27
Credit related fees and commission	34	25	34	25
Other fee and commission income	22	17	17	17
	464	**329**	**421**	**325**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

6. FEE AND COMMISSION EXPENSE

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Payments and money transfers	54	57	54	56
Bank card services	41	52	60	54
Credit related fees and commission	3	-	3	-
Other fee and commission expense	3	3	3	3
	101	112	120	113

7. NET TRADING INCOME

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Net foreign exchange gain	127	100	127	100
Gains on derivative financial instruments	93	14	93	14
Net gain on financial assets at fair value through profit or loss	12	7	12	6
	232	121	232	120

8. OTHER OPERATING INCOME

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Rental income	3	3	3	3
Income from sale of tangible fixed assets	1	-	1	-
Realized (loss)/gain on financial investments available for sale	(11)	14	(11)	14
Gains on selling of investments	25	-	25	-
Dividend income	1	2	1	2
Other	9	32	9	32
	28	51	28	51

9. PERSONNEL EXPENSES

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Employee related costs				
- Wages, salaries and compensations	197	173	193	173
- Payroll taxes and contributions	186	141	163	139
Pension provisions	1	6	1	6
Jubilee provisions	1	4	1	4
	385	324	358	322

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

9. PERSONNEL EXPENSES (CONTINUED)

The Group and the Bank do not have pension arrangements separate from the State pension system of Croatia. This system requires that current contributions by the employer be calculated as a percentage of current gross salary payments; these expenses are charged to the profit and loss statement in the period the related compensation is earned by the employee.

The number of employees as full time equivalents of the Group was 1,827 and 1,737 as at 31 December 2007 and 2006, respectively. The number of employees as full time equivalents of the Bank was 1,723 and 1,668 as at 31 December 2007 and 2006, respectively.

10. OTHER OPERATING EXPENSES

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Materials and services	219	172	198	170
Savings insurance premiums	35	31	35	31
Marketing and advertising costs	40	38	40	37
Other taxes and contributions	8	5	7	4
Other	24	15	26	15
	326	**261**	**306**	**257**

11. PROVISION FOR IMPAIRMENT LOSSES ON LOANS AND ADVANCES

Provisions for impairment losses on loans and advances charged for 2007 and 2006, comprises:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Provision for impairment loss on amounts due from banks	7	-	7	-
Provision for impairment loss on loans and advances	152	93	152	93
Provision for impairment loss on other assets	2	1	2	1
Total	**161**	**94**	**161**	**94**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

12. PROVISION FOR IMPAIRMENT LOSSES ON FINANCIAL INVESTMENTS

Provisions for impairment losses on financial investments charged for 2007 and 2006, comprises:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Provision for impairment loss on financial investments held to maturity	(4)	5	(4)	5
Total	**(4)**	**5**	**(4)**	**5**

13. INCOME TAXES

The Group and the Bank provide for taxes based on tax accounts maintained and prepared in accordance with the local tax regulations and which may differ from International Financial Reporting Standards.

The Bank and subsidiaries are subject to certain permanent tax differences due to the non-tax deductibility of certain expenses and a tax free regime for certain income.

Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Temporary differences as at 31 December 2007 and 2006 relate mostly to different methods of income and expense recognition as well as to recorded values of certain assets.

The relationship between tax expenses and accounting profit for the years ended 31 December 2007 and 2006 is explained as follows:

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

13. INCOME TAXES (CONTINUED)

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Profit before income tax	759	513	754	506
Theoretical tax calculated at a tax rate of 20% (2006: 20%)	152	103	151	101
Tax effect of permanent differences	4	2	4	2
Tax effect of temporary differences	10	12	10	12
Effect of consolidation adjustments	-	(2)	-	-
Current income tax expense	166	115	165	115
Current income tax expense	(166)	(115)	(165)	(115)
Change in deferred tax assets recognized in income statement	10	12	10	12
Income tax expense reported in the consolidated income statement	(156)	(103)	(155)	(103)

Deferred tax assets and liabilities are attributable to the following temporary differences:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Deferred assets				
Loan origination fees	188	158	188	158
Unrealized losses on investments available for sale	1	7	1	7
Unrealized losses on investments held for trading	1	2	1	2
Negative valuation of derivative financial instruments	21	7	21	7
Employment benefit provisions	11	10	11	10
Other temporary differences	10	-	10	-
Total deferred assets	232	184	232	184
Deferred liabilities				
Unrealized gains on financial investments available for sale	8	-	8	-
Borrowings origination fees	3	-	3	-
Total deferred liabilities	11	-	11	-
Deferred tax asset at the statutory tax rate (20%)	46	36	46	36
Deferred tax liabilities at the statutory tax rate (20%)	2	-	2	-

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

13. INCOME TAXES (CONTINUED)

The movement in deferred tax balances is as follows:

	GROUP AND BANK 2007			
	Deferred tax assets	Deferred tax liabilities	Income statement	Charge to equity
Deferred loan origination fees	38	-	5	-
Unrealized gains on available for sale securities	-	(2)	-	2
Unrealised losses on derivative financial instruments	4	-	3	-
Long-term employment provisions	2	-	-	-
Other temporary differences	2	-	2	1
Total	46	(2)	10	3

	GROUP AND BANK 2006			
	Deferred tax assets	Deferred tax liabilities	Income statement	Credit to equity
Deferred loan origination fees	32	-	11	-
Unrealized gains on available for sale securities	1	-	-	(1)
Unrealised losses on derivative financial instruments	1	-	-	-
Long-term employment provisions	2	-	2	-
Other temporary differences	-	-	(1)	-
Total	36	-	12	(1)

Income tax assets and liabilities consist of the following:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Current income tax liabilities	(63)	(33)	(62)	(32)
Deferred tax assets	46	36	46	36
Deferred tax liabilities	(2)	-	(2)	-
Income tax (liabilities)/assets	(19)	3	(18)	4

Croatian tax legislation and practice has changed significantly in recent years. Many parts of the legislation remain untested and there is uncertainty about the interpretation that the tax authorities may apply in a number of areas. Tax positions taken by the Group are subject to examination and could be challenged by the tax authorities. As a result there is uncertainty about the potential impacts should the interpretation of the tax authorities differ from that applied by the Group. However, the Group's Management considers that the tax liability which might arise in connection with this would not be material.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

14. CASH AND BALANCES WITH THE CROATIAN NATIONAL BANK

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Cash on hand	484	296	484	295
Cash on clearing account	1,145	1,377	1,145	1,377
Obligatory reserves with the Croatian National Bank	4,665	4,675	4,665	4,675
	6,294	**6,348**	**6,294**	**6,347**

As at 31 December 2007 and 2006, obligatory reserves with the Croatian National Bank of HRK 4,665 million and HRK 4,675 million, respectively, represent the permanent minimum reserve deposits which the Group is required to maintain at all times.

15. AMOUNTS DUE FROM OTHER BANKS

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Deposits with banks	5,289	4,282	5,094	4,130
Loans and advances with banks	174	24	168	24
Less: Allowance for possible placement losses	(19)	(11)	(17)	(11)
	5,444	**4,295**	**5,245**	**4,143**

As at 31 December 2007 and 2006, demand deposits with banks include balances at nostro accounts with correspondent banks of HRK 46 million and HRK 30 million, respectively, in the Group.

As at 31 December 2007 and 2006, demand deposits with banks include balances at nostro accounts with correspondent banks of HRK 42 million and HRK 25 million, respectively, in the Bank.

The movement in the allowances for impairment losses on amounts due from other banks is summarized as follows:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Balance at 1 January	11	12	11	12
Release of previously established allowances	(110)	-	(110)	-
Additional allowances	117	-	117	-
Collection/reversal of specific allowances due to write-offs	1	(1)	(1)	(1)
Balance at 31 December	**19**	**11**	**17**	**11**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

16. REVERSE REPURCHASE / REPURCHASE AGREEMENTS

	GROUP AND BANK - ASSETS		GROUP AND BANK - LIABILITIES	
	2007	2006	2007	2006
Banks	-	-	289	-
Other	81	132	-	-
	81	132	289	-

Reverse repurchase agreements are secured with debt securities of the Republic of Croatia with a fair value of HRK 82 million and HRK 135 million as at 31 December 2007 and 2006, respectively. As at 31 December 2007, repurchase agreements are secured with treasury bills issued by the Croatian Ministry of Finance included in 'Financial assets held for trading' with a fair value of HRK 292 million.

17. DERIVATIVE FINANCIAL INSTRUMENTS

	GROUP AND BANK 2007			GROUP AND BANK 2006		
		Fair Value			*Fair Value*	
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
Interest rate instruments:						
Interest rate swaps	-	-	-	147	8	-
Subtotal - Interest rate instruments	-	-	-	*147*	*8*	-
Foreign currency instruments:						
Currency swaps						
Purchase	*2,602*	*3*	-	*1,560*	*6*	-
Sell	*2,608*	-	*(11)*	*1,560*	-	*(7)*
Forwards						
Purchase	*6,486*	*45*	-	*1,510*	*7*	-
Sell	*6,469*	-	*(30)*	*1,503*	-	-
Call options	-	-	-	3	1	-
Put options	-	-	-	3	-	(2)
Subtotal - Foreign currency instruments	*18,165*	*48*	*(41)*	*6,139*	*14*	*(9)*
Other instruments:						
Call options for stock index	57	19	-	37	11	-
Put options for stock index	57	-	(18)	37	-	(11)
Call options for equity instruments	9	-	-	10	-	-
Put options for equity instruments	9	-	-	10	-	-
Forward bonds - purchase	232	-	-	-	-	-
Forward bonds - sell	232	-	(1)	-	-	-
Subtotal - Other instruments	*596*	*19*	*(19)*	*94*	*11*	*(11)*
	18,761	67	(60)	6,380	33	(20)

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

17. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

The fair value of these transactions reflects the credit risk and other types of economic risks for the Group and the Bank. The fair value of derivative financial instruments is based on valuation techniques where all model inputs are observable in the market, except for the put option for equity instruments, whose fair value is shown at cost.

18. FINANCIAL ASSETS AND FINANCIAL LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Financial assets held for trading:				
Treasury bills of Ministry of Finance	367	-	367	-
Bonds of the Republic of Croatia	101	163	93	153
Bonds of foreign states	-	15	-	15
Shares	8	-	8	-
Bonds of commercial customers	60	-	60	-
Commercial bills	2	-	2	-
	538	178	530	168
Financial assets designated at fair value through profit or loss:				
Due from banks	20	-	20	-
	558	178	550	168

Bonds of the Republic of Croatia are fixed income debt securities denominated in HRK and EUR and listed on stock exchanges. These bonds have maturities between 2008 and 2019 and bear a coupon interest from 3.5% to 7.25% p.a.

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Financial liabilities held for trading:				
Short position in government debt securities	7	-	7	-
	7	-	7	-
Financial liabilities designated at fair value through profit or loss:		-		-
Amounts due to other Banks	20	-	20	-
	20		20	

Financial assets held for trading are measured at fair value based on quoted prices. In circumstances where quoted market prices are not readily available, the fair value of those securities is estimated using the present value of future cash flows.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

19. LOANS AND ADVANCES TO CUSTOMERS

Loans and advances to customers as at 31 December 2007 and 2006 are summarized as follows:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Companies	12,326	10,299	12,325	10,296
Individuals	13,277	11,469	13,277	11,470
Public sector	1,133	1,015	1,133	1,015
Other institutions	27	30	27	30
Total loans before allowances for impairment	26,763	22,813	26,762	22,811
Less: Allowance for loan impairment	*(1,111)*	*(1,038)*	*(1,111)*	*(1,036)*
	25,652	**21,775**	**25,651**	**21,775**

Loans and advances to customers are made principally within Croatia.

The movement in the allowances for impairment losses on loans and advances to customers is summarized as follows:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Balance at 1 January	1,038	978	1,036	978
Release of previously established allowances	(231)	(240)	(231)	(240)
Additional allowances	383	333	383	333
Reversal of specific allowances due to write-offs	(49)	(16)	(48)	(16)
Exchange rate differences attributable to allowances	(1)	(1)	-	(3)
Interest accrued on impaired loans and advances	(29)	(16)	(29)	(16)
Balance at 31 December	1,111	1,038	1,111	1,036

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

20. FINANCIAL INVESTMENTS AVAILABLE FOR SALE

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Equity shares and participations:	*49*	*19*	*49*	*19*
Investments in companies	36	6	36	6
Investments in financial institutions	13	13	13	13
Debt securities:	*1,224*	*1,550*	*1.224*	*1,550*
Treasury bills	841	760	841	760
Listed debt securities	337	703	337	703
Unlisted debt securities - commercial bills of exchange	46	87	46	87
Units in open investment funds	*45*	*37*	*45*	*37*
Total assets available for sale	**1,318**	**1,606**	**1.318**	**1,606**
Less: Allowance for impairment of available for sale investments	*(3)*	*(3)*	*(3)*	*(3)*
	1,315	**1,603**	**1.315**	**1,603**

Debt securities available for sale allocated by the issuer comprise:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Debt securities available for sale issued by:				
State institutions in Croatia	1,149	1,372	1,149	1,372
Financial institutions in Croatia	-	37	-	37
Companies in Croatia	75	120	75	120
Foreign states	-	21	-	21
	1,224	**1,550**	**1,224**	**1,550**

Debt securities issued by State institutions in Croatia include bonds and treasury bills issued by the Croatian Ministry of Finance.

Treasury bills of the Croatian Ministry of Finance are HRK denominated debt securities issued at a discount to nominal. These securities are issued with original maturities of 91, 181 and 364 days.

During 2007, the average interest yields on the treasury bills were 3.40% for treasury bills with a maturity of 91 days, 3.54% for treasury bills with a maturity of 181 days, and 4.13% for treasury bills with a maturity of 364 days. During 2006, the average interest yields on the treasury bills were 3.04% for treasury bills with a maturity of 91 days, 3.32% for treasury bills with a maturity of 181 days, and 3.91% for treasury bills with a maturity of 364 days.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

20. FINANCIAL INVESTMENTS AVAILABLE FOR SALE (CONTINUED)

Bonds of the Republic of Croatia are HRK, EUR and USD denominated fixed income debt securities listed at stock exchanges. These bonds have maturities from 2008 to 2019 and bear coupon interest from 3.500% to 6.875% p.a.

Bonds of foreign states are fixed income debt securities denominated in EUR and listed on stock exchanges. These bonds have maturities in 2016 and bear a coupon interest of 3.50% p.a.

Financial investments available for sale are measured at fair value based on quoted prices. In circumstances where quoted market prices are not readily available, the fair value of these securities is estimated using the present value of future cash flows.

21. FINANCIAL INVESTMENTS HELD TO MATURITY

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Fixed income debt securities:	446	536	446	536
Listed debt securities				
- Bonds issued by the Republic of Croatia	280	284	280	284
Unlisted debt securities				
- Bonds issued by the Republic of Croatia	166	252	166	252
Commercial bills of exchange	-	8	-	8
Factoring	19	27	19	27
Total investments held to maturity before allowance on impairment	465	571	465	571
Less: Allowance for impairment on investments held to maturity	(1)	(5)	(1)	(5)
	464	566	464	566

Listed bonds issued by the Republic of Croatia are fixed income debt securities denominated in EUR and HRK. These bonds have maturities from 2008 to 2014 and bear coupon interest from 5.500% to 6.875%. These bonds are traded on an active market.

Unlisted bonds issued by the Republic of Croatia are foreign currency denominated bonds issued in 1997 and 2002 and repayable in twenty semi-annual instalments at interest rates ranging from 6% p.a. to 7.2% p.a. The bonds have maturities from 2008 to 2011.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

21. FINANCIAL INVESTMENTS HELD TO MATURITY (CONTINUED)

The fair value of assets held to maturity is approximately HRK 5 million higher than their value as at 31 December 2007.

The movement in the allowances for impairment losses on financial assets held to maturity is summarized as follows:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Balance at 1 January	5	-	5	-
Release of previously established allowances	(5)	-	(5)	-
Additional allowances	1	5	1	5
Balance at 31 December	1	5	1	5

22. NON-CURRENT ASSETS HELD FOR SALE

At 31 December 2006, the Bank owns 191,095 ordinary shares in Kvarner Bank d.d., accounted for in the 2005 consolidated financial statements as an associate. On 6 October 2006, the Bank entered into a sale agreement with BKS Bank AG, Austria, under which it intends to sell its investment. The sale transaction was completed during the first half of 2007.

The Group and the Bank have reclassified the investment in the associate to non-current assets held for sale in 2006. As at 31 December 2006, the investment in the associate is carried at a book value of HRK 24 million in the financial statements of the Group, and at a book value of HRK 23 million in financial statements of the Bank.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

23. INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES

	Ownership interest	Activity	Group's share of net assets		Investment at cost	
			2007	2006	2007	2006
Associates						
Erste Factoring d.o.o.	44.00%	Other credit intermediation	5	2	2	2
Erste d.o.o.	27.88%	Management company for obligatory pension fund	17	13	12	10
Erste Sparkassen d.d.	26.00%	Life insurance	5	7	10	10
IT services d.o.o.	20.00%	IT engineering	1	-	-	-
Total associates:			**28**	**22**	**24**	**22**
Subsidiaries						
Erste nekretnine d.o.o.	90.00%	Real estate business	1	-	1	1
Erste DMD d.o.o.	100.00%	Management company for voluntary pension fund	15	15	15	15
MBU d.o.o.	55.88%	IT engineering and interbank services	14	13	6	6
Total subsidiaries:			**30**	**28**	**22**	**22**
Total:			**58**	**50**	**46**	**44**

The Group's share of the results of associates can be summarized as post acquisition profits, net of dividends received, and amounted to HRK 4 million and HRK 8 million for 2007 and 2006, respectively.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

24. PROPERTY AND EQUIPMENT

	GROUP 2007				
	Land and buildings	Computers	Furniture and other equipment	Construction in progress	Total
COST					
At 1 January 2007	514	292	152	30	988
Additions	14	22	13	37	86
Disposals	(8)	(27)	(9)	(49)	(93)
At 31 December 2007	**520**	**287**	**156**	**18**	**981**
ACCUMULATED DEPRECIATION					
At 1 January 2007	132	197	88	-	417
Depreciation	13	43	19	-	75
Eliminated on disposals	(5)	(26)	(8)	-	(39)
At 31 December 2007	**140**	**214**	**99**	**-**	**453**
NET BOOK VALUE					
31 December 2007	**380**	**73**	**57**	**18**	**528**
31 December 2006	**382**	**95**	**64**	**30**	**571**

	BANK 2007				
	Land and buildings	Computers	Furniture and other equipment	Construction in progress	Total
COST					
At 1 January 2007	500	289	147	30	966
Additions	14	20	12	34	80
Disposals	(7)	(24)	(9)	(46)	(86)
At 31 December 2007	**507**	**285**	**150**	**18**	**960**
ACCUMULATED DEPRECIATION					
At 1 January 2007	132	197	87	-	416
Depreciation	12	40	17	-	69
Eliminated on disposals	(4)	(23)	(8)	-	(35)
At 31 December 2007	**140**	**214**	**96**	**-**	**450**
NET BOOK VALUE					
31 December 2007	**367**	**71**	**54**	**18**	**510**
31 December 2006	**368**	**92**	**60**	**30**	**550**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

24. PROPERTY AND EQUIPMENT (CONTINUED)

	GROUP 2006				
	Land and buildings	Computers	Furniture and other equipment	Construction in progress	Total
COST					
At 1 January 2006	467	276	141	25	909
Additions	47	20	19	69	155
Disposals	-	(4)	(8)	(64)	(76)
At 31 December 2006	**514**	**292**	**152**	**30**	**988**
ACCUMULATED DEPRECIATION					
At 1 January 2006	121	152	79	-	352
Depreciation	11	49	16	-	76
Eliminated on disposals	-	(4)	(7)	-	(11)
At 31 December 2006	**132**	**197**	**88**	**-**	**417**
NET BOOK VALUE					
31 December 2006	**382**	**95**	**64**	**30**	**571**
31 December 2005	**346**	**124**	**62**	**25**	**557**

	BANK 2006				
	Land and buildings	Computers	Furniture and other equipment	Construction in progress	Total
COST					
At 1 January 2006	467	276	141	25	909
Additions	33	17	14	69	133
Disposals	-	(4)	(8)	(64)	(76)
At 31 December 2006	**500**	**289**	**147**	**30**	**966**
ACCUMULATED DEPRECIATION					
At 1 January 2006	121	152	79	-	352
Depreciation	11	49	15	-	75
Eliminated on disposals	-	(4)	(7)	-	(11)
At 31 December 2006	**132**	**197**	**87**	**-**	**416**
NET BOOK VALUE					
31 December 2006	**368**	**92**	**60**	**30**	**550**
31 December 2005	**346**	**124**	**62**	**25**	**557**

As at 31 December 2007, the Group and the Bank had contracted capital commitments of HRK 10 million (HRK 4 million as at 31 December 2006) in respect of current capital investment projects.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

25. INTANGIBLE ASSETS

	GROUP 2007			BANK 2007		
	Intangible assets	Construction in progress	Total	Intangible assets	Construction in progress	Total
COST						
At 1 January 2007	68	4	72	58	4	62
Additions	13	16	29	13	16	29
Disposals	(3)	(13)	(16)	(2)	(13)	(15)
At 31 December 2007	78	7	85	69	7	76
ACCUMULATED DEPRECIATION						
At 1 January 2007	38	-	38	37	-	37
Depreciation	17	-	17	8	-	8
Eliminated on disposals	(6)	-	(6)	(2)	-	(2)
At 31 December 2007	49	-	49	43	-	43
NET BOOK VALUE						
31 December 2007	29	7	36	26	7	33
31 December 2006	30	4	34	21	4	25

	GROUP 2006			BANK 2006		
	Intangible assets	Construction in progress	Total	Intangible assets	Construction in progress	Total
COST						
At 1 January 2006	51	1	52	51	1	52
Additions	18	11	29	8	11	19
Disposals	(1)	(8)	(9)	(1)	(8)	(9)
At 31 December 2006	68	4	72	58	4	62
ACCUMULATED DEPRECIATION						
At 1 January 2006	29	-	29	29	-	29
Depreciation	10	-	10	9	-	9
Eliminated on disposals	(1)	-	(1)	(1)	-	(1)
At 31 December 2006	38	-	38	37	-	37
NET BOOK VALUE						
31 December 2006	30	4	34	21	4	25
31 December 2005	22	1	23	22	1	23

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

26. OTHER ASSETS

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Assets acquired in lieu of uncollected receivables	12	14	12	14
Receivables from fees and commissions	40	18	41	18
Checks	4	8	4	8
Prepaid expenses	7	11	6	11
Other	23	26	22	25
Total gross other assets	*86*	*77*	*85*	*76*
Less: Allowance for impairment of other asset	(9)	(7)	(9)	(7)
	77	70	76	69

The movement in allowances for impairment losses on loans and advances to customers is summarized as follows:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Balance at 1 January	7	6	7	6
Release of previously established allowances	(10)	(5)	(10)	(5)
Additional allowances	12	6	12	6
Balance at 31 December	9	7	9	7

27. AMOUNTS DUE TO OTHER BANKS

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Demand deposits:	128	63	128	63
In HRK	*54*	*40*	*54*	*40*
In foreign currencies	*74*	*23*	*74*	*23*
Term deposits:	2,366	2,307	2,366	2,307
In HRK	*796*	*420*	*796*	*420*
In foreign currencies	*1,570*	*1,887*	*1,570*	*1,887*
	2,494	2,370	2,494	2,370

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

28. AMOUNTS DUE TO CUSTOMERS

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Demand deposits from	7,703	6,620	7,713	6,621
Individuals	*3,992*	*3,675*	*3,992*	*3,675*
Companies	*3,318*	*2,631*	*3,328*	*2,632*
Public sector	*276*	*201*	*276*	*201*
Other institutions	*117*	*113*	*117*	*113*
Term deposits from	18,216	15,510	18,216	15,510
Individuals	*11,315*	*9,568*	*11,315*	*9,568*
Companies	*6,637*	*5,729*	*6,637*	*5,729*
Public sector	*164*	*149*	*164*	*149*
Other institutions	*100*	*64*	*100*	*64*
	25,919	22,130	25,929	22,131

29. OTHER BORROWED FUNDS

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Borrowings in HRK - short-term:	219	130	219	130
Domestic borrowings	*219*	*130*	*219*	*130*
Borrowings in HRK - long-term:	5,943	1,812	5,943	1,812
Domestic borrowings	*309*	*337*	*309*	*337*
Foreign borrowings	*5,634*	*1,475*	*5,634*	*1,475*
Total borrowings in HRK	6,162	1,942	6,162	1,942
Borrowings in foreign currencies - short-term:	4	4	4	4
Foreign borrowings	*4*	*4*	*4*	*4*
Borrowings in foreign currencies - long-term:	1,189	5,229	997	5,081
Domestic borrowings	*796*	*635*	*796*	*635*
Foreign borrowings	*295*	*4,453*	*103*	*4,305*
Refinanced borrowings	*98*	*141*	*98*	*141*
Total borrowings in foreign currencies	1,193	5,233	1,001	5,085
	7,355	7,175	7,163	7,027

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

30. OTHER LIABILITIES

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Prepayments received from borrowers	190	196	190	196
Salaries and bonuses payable	92	76	90	74
Amounts due to suppliers	30	28	30	24
Payables to DAB for customer deposit insurance	9	8	10	8
Other	41	32	36	32
	362	340	356	334

31. PROVISIONS

	GROUP				BANK			
	Litigations	Guarantees and credit commitments	Long-term employee benefits	Total	Litigations	Guarantees and credit commitments	Long-term employee benefits	Total
At 1 January 2006	1	51	-	52	1	51	-	52
Additional provisions	-	9	10	19	-	9	10	19
At 1 January 2007	1	60	10	71	1	60	10	71
Additional provisions	3	(7)	1	(3)	3	(7)	1	(3)
At 31 December 2007	4	53	11	68	4	53	11	68

Long-term employee benefits are presented within personnel expenses in the income statement.

The provision for guarantees and other loan commitments and contingent liabilities primarily relates to commitments from guarantees and credit lines issued by the Bank (Note 41).

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

32. SUBORDINATED DEBT

On 29 June 2007 the General Assembly of the Bank approved the conversion of subordinated capital of EUR 95 million in to share capital. The subordinated capital consisted of three subordinated loan agreements:

1. In 2002 Erste Bank der österreichischen Sparkassen AG Wien granted the Bank funds of EUR 20 million, based on a subordinated uncollateralized long-term loan for the formation of supplementary capital. The loan has been granted for a period of 15 years, and at an agreed interest rate of 1.20% per annum in excess of EURIBOR.
2. Also, in 2002, Erste Bank der österreichischen Sparkassen AG Wien granted the Bank funds of EUR 20 million, based on a subordinated uncollateralized long-term loan for the formation of supplementary capital. The maturity of 50% of this loan was 24 April 2011, and 24 April 2012 for the other 50%. The interest rate is 1.5% in excess of EURIBOR.
3. In 2005, Erste Bank der österreichischen Sparkassen AG Wien granted the Bank funds of EUR 55 million, based on a subordinated uncollateralized long-term loan for the formation of supplementary capital. The loan has been granted for a period of 10 years, and at an agreed interest rate of 0.90% per annum in excess of EURIBOR.

33. SHARE CAPITAL

As at 31 December 2007 the share capital of the Bank comprises 16,113,843 ordinary shares with a par value of HRK 100 each (31 December 2006: 15,134,260 ordinary shares). All the ordinary shares are ranked equally and bear one vote.

On 29 June 2007 the General Assembly of the Bank approved an increase of share capital on 2 July 2007, by conversion of subordinated capital of EUR 95 million into share capital for 979,583 new, ordinary shares with a par value of HRK 100 each thus increasing the share capital by HRK 98 million and generating additional share premium of HRK 596 million.

34. RESERVES AND RETAINED EARNINGS

The Group's distributable and non-distributable reserves are determined by regulations of the Croatian National Bank. As at 31 December 2007, the statutory and legal accounts of the Group disclose non-distributable reserves of HRK 207 million (HRK 130 million as at 31 December 2006). Such reserves include the reserve for general banking risk of HRK 126 million as of 31 December 2007 (31 December 2006: HRK 58 million). The reserve for general banking risk is formed from annual net profits and is not distributable within the following 3 years. The reserve becomes distributable if the growth rate of the Bank's assets does not exceed 15% on an annual basis.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

35. EARNINGS PER ORDINARY SHARE

For the purposes of calculating earnings per share, earnings are calculated as the net profit after tax for the period attributable to ordinary shareholders after deducting preference dividends. A reconciliation of the profit after tax attributable to ordinary shareholders is provided below.

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Net profit for the year (in HRK)	602,965,524	410,143,739	599,029,364	403,349,706
Profit attributable to ordinary shareholders (in HRK)	602,965,524	410,143,739	599,029,364	403,349,706
Weighted average number of shares of 100 HRK each (for basic and diluted earnings per share)	15,633,445	14,019,923	15,633,445	14,019,923
Earnings per ordinary share - basic and diluted (in HRK)	**38.57**	**29.25**	**38.32**	**28.77**

36. DIVIDENDS

The dividends are subject to approval by shareholders at the Annual General Assembly which had not been held as of the date when these consolidated financial statements were authorized for issue.

The dividends declared by the Bank for the years 2006 and 2005 were HRK 13.32 per share (total dividend HRK 202 million) and HRK 7.88 per share (total dividend HRK 104 million), respectively.

37. ESTIMATED FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction. Where available, fair value is based on quoted market prices. However, no readily available market prices exist for a significant portion of the Group's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing techniques as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. It is the opinion of the management of the Group that the fair value of the Group's financial assets and liabilities are not materially different from the amounts stated in the balance sheets as at 31 December 2007 and 2006.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

37. ESTIMATED FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

In estimating the fair value of the Group's financial instruments, the following methods and assumptions were used:

a) Cash and balances with the central bank

The carrying values of cash and balances with the central bank are generally deemed to approximate their fair value.

b) Investments held to maturity

Fair values of securities carried in the 'Held to maturity' portfolio are calculated based on market quotations. The fair values of held to maturity investments are disclosed in Note 21.

c) Due from banks

The estimated fair value of amounts due from banks that mature in 180 days or less approximates their carrying amounts. The fair value of other amounts due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral. Allowances are not taken into consideration when calculating fair values.

d) Loans and advances to customers

The fair value of variable yield loans that regularly reprice, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality. The fair value of non-performing loans to customers is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral, where available. Loans at fixed interest rates represent only a fraction of the total carrying value and hence the fair value of total loans and advances to customers approximates the carrying values as at the balance sheet date. Allowances are not taken into consideration when calculating fair values.

e) Amounts due to banks and customers

The fair value of term deposits payable on demand represents the carrying value of amounts payable on demand as at the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as at the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using rates currently offered for deposits of similar remaining maturities. As the fixed rate long-term deposits represent only a fraction of the entire deposit base, the Management believes that their fair value approximates the carrying values as at the balance sheet date.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

38. INFORMATION FOR CASH FLOW STATEMENT

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Operating Activities				
Profit before income tax	759	513	754	506
Adjustments to reconcile net income to net cash used in operating activities:				
Depreciation and amortization expense	92	86	77	84
Impairment losses on loans and advances	161	94	161	94
Impairment losses on financial investments	(4)	5	(4)	5
Net change in valuation of derivatives	7	(13)	7	(13)
Provisions for off balance commitments	(4)	9	(4)	9
Unrealized losses on financial assets held-for-trading	-	1	-	1
Interest expense	1,224	876	1,217	874
Interest income	(2,332)	(1,781)	(2,323)	(1,778)
Share of results of associates	(4)	(8)	-	-
Loss from operating activities before changes in operating assets and liabilities	*(101)*	*(218)*	*(115)*	*(218)*

Analysis of cash and cash equivalents:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Cash on hand	484	296	484	295
Cash on clearing account with the Croatian National Bank	1,146	1,377	1,146	1,377
Current accounts with other banks	46	30	42	25
Placements with banks with maturity up to 3 months	5,219	4,114	5,024	4,082
Treasury bills with maturity up to 3 months	258	304	258	304
	7,153	6,121	6,954	6,083
Change in cash and cash equivalents	1,032		871	

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

Liquidity risk is a measure of the extent to which the Group may be required to raise funds to meet its commitments associated with financial instruments. The Group maintains its liquidity profiles in accordance with regulations laid down by the Croatian National Bank. The table below provides an analysis of assets and liabilities into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment schedules allow for early repayment possibilities. Those assets and liabilities that do not have a contractual maturity date are grouped together under the 'Maturity undefined' category.

Investments available for sale are classified in accordance with their secondary liquidity characteristics as maturing within one month.

The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns, guarantees and from margin and other calls on cash-settled derivatives. The Group does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Group sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

	GROUP 2007								
	Up to 1 month	1-3 months	3-12 months	Subtotal less than 12 months	1-5 years	Over 5 years	Subtotal over 12 months	Maturity unde-fined	Total
ASSETS									
Cash and balances with the Croatian National Bank	1,665	2,008	966	4,639	1,571	84	1,655	-	6,294
Amounts due from other banks	4,973	469	-	5,442	2	-	2	-	5,444
Reverse repurchase agreements	81	-	-	81	-	-	-	-	81
Receivables on financial derivative transactions	67	-	-	67	-	-	-	-	67
Financial assets held for trading	538	-	-	538	-	-	-	-	538
Financial assets at fair value through profit or loss	-	20	-	20	-	-	-	-	20
Loans and advances to customers, net	2,713	1,435	3,665	7,813	10,773	7,066	17,839	-	25,652
Financial investments available for sale	1,315	-	-	1,315	-	-	-	-	1,315
Financial investments held to maturity	273	24	22	319	145	-	145	-	464
Investments in subsidiaries and associates	-	-	-	-	-	-	-	28	28
Property and equipment	-	-	-	-	148	380	528	-	528
Intangible assets	-	-	-	-	36	-	36	-	36
Deferred tax assets	46	-	-	46	-	-	-	-	46
Other assets	43	19	-	62	15	-	15	-	77
Total assets	**11,714**	**3,975**	**4,653**	**20,342**	**12,690**	**7,530**	**20,220**	**28**	**40,590**
LIABILITIES AND SHAREHOLDERS' EQUITY									
Amounts due to other banks	930	87	1,477	2,494	-	-	-	-	2,494
Repurchase agreements	289	-	-	289	-	-	-	-	289
Payables on financial derivative transactions	60	-	-	60	-	-	-	-	60
Financial liabilities held for trading	7	-	-	7	-	-	-	-	7
Financial liabilities at fair value through profit or loss	-	20	-	20	-	-	-	-	20
Amounts due to customers	8,850	6,060	7,666	22,576	2,752	591	3,343	-	25,919
Other borrowed funds	93	127	508	728	6,319	308	6,627	-	7,355
Current tax liabilities	-	-	63	63	-	-	-	-	63
Deferred tax liabilities	2	-	-	2	-	-	-	-	2
Other liabilities	275	-	87	362	-	-	-	-	362
Provisions	23	5	24	52	15	1	16	-	68
Equity attributable to equity holders of the Bank	-	-	300	300	-	-	-	3,639	3,939
Minority interest	-	-	-	-	-	-	-	12	12
Total liabilities and shareholder's equity	**10,529**	**6,299**	**10,125**	**26,953**	**9,086**	**900**	**9,986**	**3,651**	**40,590**
Net liquidity gap	**1,185**	**(2,324)**	**(5,472)**	**(6,611)**	**3,604**	**6,630**	**10,234**	**(3,623)**	**-**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

	BANK 2007								
	Up to 1 month	1-3 months	3-12 months	Subtotal less than 12 months	1-5 years	Over 5 years	Subtotal over 12 months	Maturity unde-fined	Total
ASSETS									
Cash and balances with the Croatian National Bank	1,665	2,008	966	4,639	1,571	84	1,655	-	6,294
Amounts due from other banks	4,963	279	1	5,243	2	-	2	-	5,245
Reverse repurchase agreements	81	-	-	81	-	-	-	-	81
Receivables on financial derivative transactions	67	-	-	67	-	-	-	-	67
Financial assets held for trading	530	-	-	530	-	-	-	-	530
Financial assets at fair value through profit or loss	-	20	-	20	-	-	-	-	20
Loans and advances to customers, net	2,711	1,435	3,666	7,812	10,773	7,066	17,839	-	25,651
Financial investments available for sale	1,315	-	-	1,315	-	-	-	-	1,315
Financial investments held to maturity	274	24	22	320	144	-	144	-	464
Investments in subsidiaries and associates	-	-	-	-	-	-	-	46	46
Property and equipment	-	-	-	-	144	366	510	-	510
Intangible assets	-	-	-	-	33	-	33	-	33
Deferred tax assets	46	-	-	46	-	-	-	-	46
Other assets	42	19	-	61	15	-	15	-	76
Total assets	**11,694**	**3,785**	**4,655**	**20,134**	**12,682**	**7,516**	**20,198**	**46**	**40,378**
LIABILITIES AND SHAREHOLDERS' EQUITY									
Amounts due to other banks	930	87	1,477	2,494	-	-	-	-	2,494
Repurchase agreements	289	-	-	289	-	-	-	-	289
Payables on financial derivative transactions	60	-	-	60	-	-	-	-	60
Financial liabilities held for trading	7	-	-	7	-	-	-	-	7
Financial liabilities at fair value through profit or loss	-	20	-	20	-	-	-	-	20
Amounts due to customers	8,855	6,063	7,667	22,585	2,753	591	3,344	-	25,929
Other borrowed funds	48	126	508	682	6,173	308	6,481	-	7,163
Current tax liabilities	-	-	62	62	-	-	-	-	62
Deferred tax liabilities	2	-	-	2	-	-	-	-	2
Other liabilities	268	-	88	356	-	-	-	-	356
Provisions	23	5	24	52	15	1	16	-	68
Equity attributable to equity holders of the Bank	-	-	300	300	-	-	-	3,628	3,928
Total liabilities and shareholder's equity	**10,482**	**6,301**	**10,126**	**26,909**	**8,941**	**900**	**9,841**	**3,628**	**40,378**
Net liquidity gap	**1,212**	**(2,516)**	**(5,471)**	**(6,775)**	**3,741**	**6,616**	**10,357**	**(3,582)**	**-**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

	GROUP 2006								
	Up to 1 month	1-3 months	3-12 months	Subtotal less than 12 months	1-5 years	Over 5 years	Subtotal over 12 months	Maturity undefined	Total
ASSETS									
Cash and balances with the Croatian National Bank	1,698	1,790	911	4,399	1,734	215	1,949	-	6,348
Amounts due from other banks	4,153	14	125	4,292	3	-	3	-	4,295
Reverse repurchase agreements	132	-	-	132	-	-	-	-	132
Receivables on financial derivative transactions	33	-	-	33	-	-	-	-	33
Financial assets held for trading	178	-	-	178	-	-	-	-	178
Loans and advances to customers, net	2,621	809	3,204	6,634	9,570	5,571	15,141	-	21,775
Financial investments available for sale	1,603	-	-	1,603	-	-	-	-	1,603
Financial investments held to maturity	130	24	221	375	191	-	191	-	566
Non-current assets held for sale	24	-	-	24	-	-	-	-	24
Investments in subsidiaries and associates	-	-	-	-	-	-	-	22	22
Property and equipment	-	-	-	-	189	382	571	-	571
Intangible assets	-	-	-	-	34	-	34	-	34
Deferred tax assets	36	-	-	36	-	-	-	-	36
Other assets	53	-	-	53	17	-	17	-	70
Total assets	10,661	2,637	4,461	17,759	11,738	6,168	17,906	22	35,687
LIABILITIES AND SHAREHOLDERS' EQUITY									
Amounts due to other banks	713	68	903	1,684	686	-	686	-	2,370
Payables on financial derivative transactions	20	-	-	20	-	-	-	-	20
Amounts due to customers	6,961	4,952	7,604	19,517	2,094	519	2,613	-	22,130
Other borrowed funds	56	89	418	563	6,354	258	6,612	-	7,175
Current tax liabilities	-	-	33	33	-	-	-	-	33
Other liabilities	277	-	63	340	-	-	-	-	340
Provisions	22	4	26	52	17	2	19	-	71
Subordinated debt	-	6	-	6	74	624	698	-	704
Equity attributable to equity holders of the Bank	-	-	202	202	-	-	-	2,630	2,832
Minority interest	-	-	-	-	-	-	-	12	12
Total liabilities and shareholder's equity	8,049	5,119	9,249	22,417	9,225	1,403	10,628	2,642	35,687
Net liquidity gap	2,612	(2,482)	(4,788)	(4,658)	2,513	4,765	7,278	(2,620)	-

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

39. MATURITY ANALYSIS OF ASSETS AND LIABILITIES (CONTINUED)

	BANK 2006								
	Up to 1 month	1-3 months	3-12 months	Subtotal less than 12 months	1-5 years	Over 5 years	Subtotal over 12 months	Maturity unde-fined	Total
ASSETS									
Cash and balances with the Croatian National Bank	1,698	1,790	910	4,398	1,734	215	1,949	-	6,347
Amounts due from other banks	4,115	14	12	4,141	2	-	2	-	4,143
Reverse repurchase agreements	132	-	-	132	-	-	-	-	132
Receivables on financial derivative transactions	33	-	-	33	-	-	-	-	33
Financial assets held for trading	168	-	-	168	-	-	-	-	168
Loans and advances to customers, net	2,621	809	3,204	6,634	9,570	5,571	15,141	-	21,775
Financial investments available for sale	1,603	-	-	1,603	-	-	-	-	1,603
Financial investments held to maturity	130	24	221	375	191	-	191	-	566
Non-current assets held for sale	23	-	-	23	-	-	-	-	23
Investments in subsidiaries and associates	-	-	-	-	-	-	-	44	44
Property and equipment	-	-	-	-	182	368	550	-	550
Intangible assets	-	-	-	-	25	-	25	-	25
Deferred tax assets	36	-	-	36	-	-	-	-	36
Other assets	52	-	-	52	17	-	17	-	69
Total assets	**10,611**	**2,637**	**4,347**	**17,595**	**11,721**	**6,154**	**17,875**	**44**	**35,514**
LIABILITIES AND SHAREHOLDERS' EQUITY									
Amounts due to other banks	714	68	902	1,684	686	-	686	-	2,370
Payables on financial derivative transactions	20	-	-	20	-	-	-	-	20
Amounts due to customers	6,962	4,952	7,604	19,518	2,094	519	2,613	-	22,131
Other borrowed funds	54	88	420	562	6,207	258	6,465	-	7,027
Current tax liabilities	-	-	32	32	-	-	-	-	32
Other liabilities	271	-	63	334	-	-	-	-	334
Provisions	22	4	26	52	17	2	19	-	71
Subordinated debt	-	6	-	6	74	624	698	-	704
Equity attributable to equity holders of the Bank	-	-	202	202	-	-	-	2,623	2,825
Total liabilities and shareholder's equity	**8,043**	**5,118**	**9,249**	**22,410**	**9,078**	**1,403**	**10,481**	**2,623**	**35,514**
Net liquidity gap	**2,568**	**(2,481)**	**(4,902)**	**(4,815)**	**2,643**	**4,751**	**7,394**	**(2,579)**	**-**

The maturity analysis is prepared in accordance with the internal Asset Liability management policy.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

40. RELATED-PARTY TRANSACTIONS

In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

The parent company (which is also the ultimate parent entity of the entire group) is Erste Bank der österreichischen Sparkassen AG, Vienna ('EBV').

As at 31 December 2007 and 31 December 2006, balances outstanding with related parties comprised:

	GROUP					
	31 December 2007			31 December 2006		
	Amounts due from banks and customers	Receivables from financial derivative transactions	Other receivables	Amounts due from banks and customers	Receivables from financial derivative transactions	Other receivables
Parent company	268	38	-	424	21	-
Entity with significant influence on the Group	18	5	-	-	-	-
Associates	48	-	-	-	-	1
Key management personnel	14	-	-	13	-	-
Other EBV Group companies	135	-	-	106	-	-
Other	112	-	16	232	-	2
Total assets	**595**	**43**	**16**	**775**	**21**	**3**

	GROUP					
	31 December 2007			31 December 2006		
	Amounts due to banks and customers	Payables on financial derivative transactions	Other payables	Amounts due to banks and customers	Payables on financial derivative transactions	Other payables
Parent company	5,587	16	2	7,543	5	701
Entity with significant influence on the Group	1,719	10	-	70	-	-
Associates	37	-	1	2	-	7
Key management personnel	54	-	-	60	-	-
Other EBV Group companies	66	-	4	71	-	4
Other	245	-	-	232	-	4
Total liabilities	**7,708**	**26**	**7**	**7,978**	**5**	**716**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

40. RELATED-PARTY TRANSACTIONS (CONTINUED)

	BANK					
	31 December 2007			31 December 2006		
	Amounts due from banks and customers	Receivables from financial derivative transactions	Other receivables	Amounts due from banks and customers	Receivables from financial derivative transactions	Other receivables
Parent company	267	38	-	424	21	-
Entity with significant influence on the Group	18	5	-	-	-	-
Associates	37	-	-	-	-	1
Key management personnel	14	-	-	13	-	-
Other EBV Group companies	145	-	-	121	-	-
Other	112	-	19	233	-	2
Total assets	**593**	**43**	**19**	**791**	**21**	**3**

	BANK					
	31 December 2007			31 December 2006		
	Amounts due to banks and customers	Payables on financial derivative transactions	Other payables	Amounts due to banks and customers	Payables on financial derivative transactions	Other payables
Parent company	5,439	16	2	7,395	5	701
Entity with significant influence on the Group	1,719	10	-	70	-	-
Associates	37	-	1	2	-	7
Key management personnel	54	-	-	60	-	-
Other EBV Group companies	76	-	6	72	-	4
Other	245	-	-	232	-	4
Total liabilities	**7,570**	**26**	**9**	**7,831**	**5**	**716**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

40. RELATED-PARTY TRANSACTIONS (CONTINUED)

Transactions with related parties comprised:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Interest income				
Parent company	250	36	250	36
Entity with significant influence on the Group	88	-	88	-
Associates	-	1	-	1
Other EBV Group companies	8	5	8	5
Other	12	9	12	9
Fee income				
Parent company	4	4	2	2
Associates	14	9	14	9
Other EBV Group companies	19	6	7	2
Other	35	8	35	8
Other operating income				
Parent company	-	1	-	1
Associates	1	2	1	2
Other EBV Group companies	5	10	5	10
Other	-	1	-	1
Total income	436	92	422	86

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Interest expenses				
Parent company	461	294	454	290
Entity with significant influence on the Group	150	3	150	3
Associates	-	3	-	3
Other EBV Group companies	-	3	-	3
Other	2	2	2	2
Fee expense				
Parent company	4	1	4	1
Other EBV Group companies	-	-	22	22
Administrative expenses				
Parent company	2	6	2	6
Associates	13	-	13	-
Other EBV Group companies	15	12	19	15
Other	4	-	2	-
Total expenses	651	324	668	345

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

40. RELATED-PARTY TRANSACTIONS (CONTINUED)

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Commitments and contingent liabilities				
Guarantees issued				
Other EBV Group companies	34	11	34	11
Other	29	-	29	-
Other				
Associates	1	-	1	-
Key management personnel	4	-	4	-
Other EBV Group companies	22	2	25	4
Other	1	-	1	-
	91	13	94	15

In 2005 the Bank purchased a put option from Erste-Sparinvest Kapitalanlagegesellschaft m.b.H. and sold a call option for an equity instrument. The exercise price for the put option amounts to HRK 10 million plus interest of 11.7% p.a., and the exercise price of the call option amounts to HRK 10 million plus an interest of 12.3% p.a. Both options can be realized at any time until July 2011. The underlying equity instrument is not publicly traded and its fair value cannot be reliably measured, and, therefore, the fair values of the options were not determined in these consolidated financial statements. It is the opinion of the management of the Bank that exercising any of the options would not materially impact the financial position of the Bank.

The remuneration of directors and other members of key management was as follows:

	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Wages and salaries	13	13	8	10
Bonuses	11	8	11	8
	24	21	19	18

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT

41.1. Introduction

Financial risk is in certain areas managed primarily on the Bank level (particularly related to legal requirements which apply only to the Bank), while in some other areas it is also managed and monitored on a Group wide basis as deemed appropriate by the Management. The disclosures included in this note are clearly marked as Bank or Group, based on the actual level on which the risk is managed or monitored.

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring subject to risk limits for certain types of risk exposure. The Bank has set up a risk management system aimed at attaining an optimal trade-off between risk and profit. The risk management system has been established as an ongoing management process of credit, market, liquidity, operational and other risk management which can arise through the Bank's daily business.

Risk management structure

Supervisory board
The Supervisory Board has the responsibility to monitor the overall risk process within the Bank.

Management Board
The Management Board, with Supervisory Board consent if needed, is empowered to determine procedures and is responsible for their enforcement through approving and passing acts which define and regulate the Bank's business. One of the Management Board members is responsible for the control and monitoring of all the Bank's risks through being responsible for the business activity of the Risk Management Division.

Risk Management Division
The Risk Management Division is entrusted with ensuring the foundations for effective risk management, as well as the management and control of decisions related to the Bank's risk exposure.
The Risk Management Division is responsible for the development of risk strategy and management principles, frameworks, policies and limits, and is liable for the implementation and the maintenance of procedures which enable independent control processes.
Also, responsibilities of the Risk Management Division are the revision of acts within its competence, carrying out appropriateness controls and effect analyses, and if deemed necessary, any alignments for the upcoming period.

ALM Department
The ALM Department is responsible for managing the Bank's assets and liabilities and the overall financial structure. It is also primarily responsible for the funding and liquidity risks of the Bank.

Internal audit
Risk Management processes throughout the Bank are audited regularly by the internal audit function, which examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal audit discusses the results of all assessments with management and also reports its findings and recommendations.

Risk measurement and reporting system

The Bank risks are measured using a method which reflects both the expected loss likely to arise in normal circumstances and unexpected losses, which are an estimate of the ultimate actual loss based on statistical models. The models make use of probabilities derived from historical experience, adjusted to reflect the economic environment, as well as to test their validity on a regular basis.

Monitoring and controlling risk is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept. In addition, the Bank monitors and measures the overall risk bearing capacity in relation to aggregate risk exposure across all risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyze, control and identify early risks.

The Management Board and the Supervisory Board receive reports regularly on the credit portfolio quality from different risk

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

aspects ensuring all vital information for the overview of the credit risk to which the Bank is exposed. The report includes detailed information on exposures, ratings, concentration and risk profile changes. The Risk Management Division compiles additional reports which provide information necessary for a proactive approach in the risk management of the credit portfolio.

A daily briefing is given to the relevant members of the Bank on the utilization of market limits, analysis of VaR, plus any other risk developments. These risk developments are presented in the form of an aggregated report.

Risk mitigation

As part of its overall risk management, the Bank uses derivatives and other instruments to manage exposure resulting from changes in interest rates, foreign currencies, equity risks, credit risks, and exposures arising from forecast transactions. The Bank actively uses collateral to reduce its credit risk.

Risk concentration

Concentration arises when a number of counterparties are engaged in similar business activities or have similar economic features that would influence their ability to meet their contractual obligation if external factors change. Concentration indicates the relative sensitivity of the Bank's performance to developments affecting a particular segment. Risk is managed through avoiding excessive concentration of risk, through specific guidelines to focus on maintaining a diversified portfolio.

41.2. Credit risk

Credit risk is the risk that the Bank and the Group will incur a loss because its customers or counterparties failed to fulfil their contractual obligations.

The credit risk management system encompasses all measures and rules determined by external legal regulations in force, internal acts as well as a proactive approach of harmonization with the guidelines and best practices of the Basel II Accord.

The role of the Risk Management Division is the control through all parts of the credit exposure approval process and further credit portfolio monitoring. This includes overview and assessment of the quality of the credit portfolio and identification and revision of adequate provisions for the loans and losses respectively, per client and for the overall portfolio.

For this purpose, a classification of credit assets into risk classes based on internal ratings of customers is in place, which follows best business practices of credit risk management.

Internal rating systems consist of eight rating grades for customers not in default and one grade for customers in default. For all other clients, the internal rating systems consist of 13 rating grades for customers not in default and one rating grade for those in default. Credit exposure is divided into the following risk classes: low risk, management attention, substandard, and non-performing.

The Bank also offers financial instruments which represent a potential obligation such as guarantees and letters of credit. These instruments expose the Bank to similar risks to loans and are mitigated by the same processes and policies.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Maximum exposure to credit risk without taking account of any collateral and other credit enhancements

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown net, before the effect of mitigation through the use of master netting and collateral agreements.

	Notes	GROUP 2007	GROUP 2006	BANK 2007	BANK 2006
Cash and balances with the Croatian National Bank	14	5,810	6,052	5,810	6,052
Amounts due from other banks	15	5,444	4,295	5,245	4,143
Reverse repurchase agreements	16	81	132	81	132
Receivables on financial derivative transactions	17	67	33	67	33
Financial assets held for trading	18	538	178	530	168
Financial assets at fair value through profit or loss	18	20	-	20	-
Loans and advances to customers	19	25,652	21,775	25,651	21,775
Financial investments available for sale	20	1,315	1,603	1,315	1,603
Financial investments held to maturity	21	464	566	464	566
Non-current assets held for sale	22	-	24	-	23
Investments in subsidiaries and associates	23	28	22	46	44
Other assets (included only fees and other)	26	54	37	54	36
Total assets		39,473	34,717	39,283	34,575
Contingent liabilities and commitments		4,092	4,181	4,092	4,181
Total credit risk exposure		43,565	38,898	43,375	38,756

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Risk concentration of maximum exposure to credit risk

Concentration of risk is managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any client or counterparty without exposure to the Republic of Croatia as of 31 December 2007 was HRK 368 million (2006: HRK 445 million) before taking account of collateral or other credit enhancements and HRK 367 million (2006: HRK 441 million) net of such security.

The Bank's and the Group's financial assets, before and after taking into account any collateral held, or other credit enhancements, can be analysed by the following geographical regions:

	GROUP					
	31 December 2007			31 December 2006		
	Banking activities	Trading activities	Total	Banking activities	Trading activities	Total
Croatia	37,701	638	38,339	34,825	178	35,003
EU Countries	4,034	-	4,034	2,990	15	3,005
Other European countries	849	-	849	656	-	656
Latin America	249	-	249	181	-	181
United States of America	10	-	10	6	-	6
Other countries	84	-	84	47	-	47
Total	42,927	638	43,565	38,705	193	38,898

	BANK					
	31 December 2007			31 December 2006		
	Banking activities	Trading activities	Total	Banking activities	Trading activities	Total
Croatia	37,519	630	38,149	34,708	153	34,861
EU Countries	4,034	-	4,034	2,990	15	3,005
Other European countries	849	-	849	656	-	656
Latin America	249	-	249	181	-	181
United States of America	10	-	10	6	-	6
Other countries	84	-	84	47	-	47
Total	42,745	630	43,375	38,588	168	38,756

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

An industry sector analysis of the Bank's and the Group's financial assets, before and after taking into account collateral held or other credit enhancements, is as follows:

	GROUP			
	2007		2006	
	Gross maximum exposure	Net maximum exposure	Gross maximum exposure	Net maximum exposure
Agriculture and forestry	387	254	348	224
Fishing	88	57	44	24
Mining	50	43	51	46
Manufacturing	3,211	1,864	3,065	1,650
Energy and water supply	194	187	235	226
Construction	2,753	1,786	2,239	1,525
Trade	3,974	2,312	3,622	2,160
Hotels and restaurants	1,830	795	1,486	483
Transport and communication	951	546	756	445
Banking and insurance	11,729	11,225	10,813	10,056
Real estate and other business activities	2,194	1,187	1,519	923
Public administration	3,203	3,146	3,149	3,093
Education services	33	21	36	19
Health and social work	131	62	120	55
Other service activities	267	190	219	144
Private households	12,570	8,436	11,196	7,639
	43,565	32,111	38,898	28,712

	BANK			
	2007		2006	
	Gross maximum exposure	Net maximum exposure	Gross maximum exposure	Net maximum exposure
Agriculture and forestry	386	254	348	224
Fishing	88	57	44	24
Mining	50	43	51	46
Manufacturing	3,212	1,864	3,065	1,650
Energy and water supply	194	187	235	226
Construction	2,753	1,786	2,239	1,525
Trade	3,974	2,311	3,622	2,160
Hotels and restaurants	1,830	795	1,486	483
Transport and communication	951	546	756	445
Banking and insurance	11,545	11,040	10,674	9,917
Real estate and other business activities	2,201	1,190	1,527	915
Public administration	3,191	3,134	3,138	3,083
Education services	33	21	36	19
Health and social work	131	62	120	55
Other service activities	265	189	218	144
Private households	12,571	8,435	11,197	7,639
	43,375	31,914	38,756	28,555

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptance of types of collateral and valuation parameters. Monitoring of the market value of collateral is performed on a regular basis.

The types of collateral obtained are mortgages over residential or real estate properties, cash deposits, securities and guarantees issued by the Republic of Croatia or banks.

Credit quality per class of financial assets

The credit quality of financial assets is managed by the Bank using internal credit ratings. The table below shows the credit quality by class of asset for loan-related balance sheet lines, based on the Bank's credit rating system.

			GROUP 2007			
	Notes		Not impaired		Impaired	Total
		Low risk	Management attention	Sub-standard		
Amounts due from other banks	15	5,226	225	-	12	5,463
Financial assets at fair value through profit or loss:						
Amounts due from other banks	16	20	-	-	-	20
Loans and advances to customers		17,493	7,284	936	1,050	26,763
Companies	*19*	*7,482*	*4,098*	*252*	*494*	*12,326*
Individuals	*19*	*8,936*	*3,103*	*683*	*555*	*13,277*
Public sector	*19*	*1,057*	*75*	*-*	*1*	*1,133*
Other institutions	*19*	*18*	*8*	*1*	*-*	*27*
Financial investments		1,685	44	-	5	1,734
Treasury bills	*20*	*841*	*-*	*-*	*-*	*841*
Listed debt securities	*20,21*	*588*	*29*	*-*	*-*	*617*
Unlisted debt securities	*20,21*	*193*	*15*	*-*	*4*	*212*
Units in open investment funds	*20*	*45*	*-*	*-*	*-*	*45*
Factoring	*21*	*18*	*-*	*-*	*1*	*19*
Total		24,424	7,553	936	1,067	33,980

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

	BANK 2007					
	Notes	Not impaired			Impaired	Total
		Low risk	Management attention	Sub-standard		
Amounts due from other banks	15	5,027	224	-	11	5,262
Financial assets at fair value through profit or loss:						
Amounts due from other banks	16	20	-	-	-	20
Loans and advances to customers		17,493	7,283	936	1,050	26,762
Companies	*19*	*7,482*	*4,097*	*252*	*494*	*12,325*
Individuals	*19*	*8,936*	*3,103*	*683*	*555*	*13,277*
Public sector	*19*	*1,057*	*75*	-	*1*	*1,133*
Other institutions	*19*	*18*	*8*	*1*	-	*27*
Financial investments		1,685	44	-	5	1,734
Treasury bills	*20*	*841*	-	-	-	*841*
Listed debt securities	*20,21*	*588*	*29*	-	-	*617*
Unlisted debt securities	*20,21*	*193*	*15*	-	*4*	*212*
Units in open investment funds	*20*	*45*	-	-	-	*45*
Factoring	*21*	*18*	-	-	*1*	*19*
Total		24,225	7,551	936	1,066	33,778

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

	GROUP 2006					
	Notes	Not impaired			Impaired	Total
		Low risk	Management attention	Sub-standard		
Amounts due from other banks	15	3,747	548	-	11	4,306
Loans and advances to customers		17,327	3,877	620	989	22,813
Companies	*19*	*5,315*	*3,865*	*590*	*529*	*10,299*
Individuals	*19*	*10,980*	*-*	*30*	*459*	*11,469*
Public sector	*19*	*1,014*	*-*	*-*	*1*	*1,015*
Other institutions	*19*	*18*	*12*	*-*	*-*	*30*
Financial investments		2,086	67	2	3	2,158
Treasury bills	*20*	*760*	*-*	*-*	*-*	*760*
Listed debt securities	*20,21*	*966*	*21*	*-*	*-*	*987*
Unlisted debt securities	*20,21*	*296*	*46*	*2*	*3*	*347*
Units in open investment funds	*20*	*37*	*-*	*-*	*-*	*37*
Factoring	*21*	*27*	*-*	*-*	*-*	*27*
Total		23,160	4,492	622	1,003	29,277

	BANK 2006					
	Notes	Not impaired			Impaired	Total
		Low risk	Management attention	Sub-standard		
Amounts due from other banks	15	3,747	396	-	11	4,154
Loans and advances to customers		17,327	3,876	620	988	22,811
Companies	*19*	*5,314*	*3,864*	*590*	*528*	*10,296*
Individuals	*19*	*10,981*	*-*	*30*	*459*	*11,470*
Public sector	*19*	*1,014*	*-*	*-*	*1*	*1,015*
Other institutions	*19*	*18*	*12*	*-*	*-*	*30*
Financial investments		2,086	67	2	3	2,158
Treasury bills	*20*	*760*	*-*	*-*	*-*	*760*
Listed debt securities	*20,21*	*966*	*21*	*-*	*-*	*987*
Unlisted debt securities	*20,21*	*296*	*46*	*2*	*3*	*347*
Units in open investment funds	*20*	*37*	*-*	*-*	*-*	*37*
Factoring	*21*	*27*	*-*	*-*	*-*	*27*
Total		23,160	4,339	622	1,002	29,123

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Aging analysis of past due but not impaired loans per class of financial assets

	GROUP AND BANK 2007				
	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Loans and advances to customers					
Companies	1,117	627	119	70	1,933
Individuals	306	83	13	12	414
Public sector	44	31	2	36	113
Other institutions	1	3	-	-	4
	1,468	744	134	118	2,464

	GROUP AND BANK 2006				
	Less than 30 days	31 to 60 days	61 to 90 days	More than 91 days	Total
Amounts due from other banks	2	-	-	-	2
Loans and advances to customers					
Companies	1,066	352	94	2	1,514
Individuals	528	73	6	24	631
Public sector	154	3	-	1	158
Other institutions	7	1	-	-	8
	1,757	429	100	27	2,313

Carrying amount per class of financial assets whose terms have been renegotiated

The table below shows the carrying amount for renegotiated financial assets.

	GROUP AND BANK	
	2007	2006
Loans and advances to customers		
Companies	30	40
Individuals	7	4
Total renegotiated financial assets	37	44

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

41.3. Liquidity risk and funding management

The Bank manages assets and liabilities, including their financial and cash flows as well as their concentration, all with the aim of harmonizing the Bank's money inflow/outflow. In order to achieve this, the Bank needs to monitor and plan liquidity, which will enable the evaluation of future needs for liquid resources, bearing in mind the changes in economic, political, regulatory and other business effecting variables. This type of planning includes the identification of known, expected and potential money outflows and creation of strategies in order to ensure the Bank's needs for money inflows in respective currencies.

The Bank's strategy is orientated towards ensuring an adequate liquidity level, which satisfies expected and unexpected money demand. In case of unexpected need for liquidity, the Bank takes measures necessary for liquidity management, such as the control of the Bank's loans activities, maximising liquid assets, selling/collateralising of securities, the withdrawal of credit lines and all other necessary measures.

In order to fulfil all legal restrictions and internal rules, following the principles of safety and stability and considering the realization of the planned profitability of the business, a system of limits measurement and liquidity risk reporting is implemented in the Bank.

Legal restrictions

With respect to the Decision on the Reserve Requirement imposed by the CNB, the Bank is obliged to calculate and maintain an obligatory reserve for HRK and FX sources of funding. The calculation period lasts from the first to the last day of a calendar month. The reserve requirement rate is 17%. The average percentage for allocating reserve requirements on special account with the CNB amounts to 70% of total obligatory reserve, while the remaining portion of the amount of 30% may be maintained through average daily balances of other liquid fund balances as defined by the CNB.

Following the Decision on the Marginal Reserve Requirement, the Bank is also obliged to calculate and allocate the entire marginal reserve requirement in foreign currency to the foreign exchange accounts of the Croatian National Bank. The basis for calculation is the positive difference between the average daily balance of specific sources of funds (non-residents and legal persons with a special relationship with the Bank) specific off-balance sheet items (contingent liabilities) in a particular calculation period, and the average daily balance of these sources of funds and contingent liabilities in the initial calculation periods. The marginal reserve requirement rate is 40%, or 55%, depending on the initial calculation period for the specific basis. The Croatian National Bank does not pay any interest on the allocated marginal reserve requirement.

Following the Decision on the Purchase of Compulsory CNB Bills, the Bank will have to purchase non-material, non-transferable compulsory CNB bills denominated in HRK, with a maturity of 1 year if the growth of placements exceeds the permissible growth stipulated by the Decision. The basis is composed of certain on-balance and off-balance sheet components. By strictly monitoring the placements' growth, the Bank did not exceed that limit in 2007.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

The Bank is obliged to maintain a minimum of 32% of foreign currency liabilities in short-term assets according to the Decision on minimal required FX claims. The actual figures were as follows:

2007	%	2006	%
'32% ratio' (at year end)	40.55	'32% ratio' (at year end)	27.46
Average	34.99	Average	43.77
Maximum	45.42	Maximum	72.38
Minimum	27.92	Minimum	22.70

Note: The Croatian National Bank broadened the base for the 32% calculation in September 2006, on the Banks' liabilities to include both HRK deposits and credit with foreign currency clause, no matter whether resident or non-resident (NN 104/06) resulting in a situation where this ratio was for many banks below 32% at the start, however allowing time until they reach the required level of 32% at the pace of 2% per month. The Bank reached the required level of 32% as at 28 February 2007 by restructuring the balance sheet.

Internal regulations

Apart from the aforementioned regulatory requirements, following internal regulations, the Bank is obliged to monitor structural indicators of liquidity risk level and concentration indicators.

Structural indicators show ratios of different assets and liabilities items such as: share of liquid assets in total assets, received deposits and total assets ratio, share of total received term deposits in total received deposits of the Bank, placed loans and total assets ratio, total placed loans and total received deposits, interbank financing and total assets ratio, share of held to maturity long-term debt securities in total assets, share of securities in the available for sale portfolio in total assets, share of long-term debt securities in the trading portfolio in total assets and the share of short-term debt securities in the trading portfolio in total assets.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Concentration indicators monitor the concentration of deponents (the biggest deponents being individuals, legal entities and financial institutions as a percent of total deposits of the Bank and as a percent of a specific segment) and the concentration of sources of funding (the ten biggest individuals, legal entities and financial institutions in total liabilities, the share of interbank deposits in total liabilities, and the share of received loans and deposits in total liabilities).

Analysis of financial liabilities by remaining contractual maturities

The table below summarises the maturity profile of the Bank's and the Group's financial liabilities at 31 December 2007 and 31 December 2006 based on contractual undiscounted repayment obligations.

	GROUP 2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Amounts due to other banks	930	87	1,477	-	-	2,494
Repurchase agreements	289	-	-	-	-	289
Payables on financial derivative transactions	36	4	2	18	-	60
Financial liabilities held for trading	7	-	-	-	-	7
Financial liabilities at fair value through profit or loss	-	20	-	-	-	20
Amounts due to customers	8,860	6,060	7,666	2,752	591	25,929
Other borrowed funds	93	127	508	6,319	308	7,355
Total undiscounted financial liabilities	10,215	6,298	9,653	9,089	899	36,154

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

	BANK 2007					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Amounts due to other banks	930	87	1,477	-	-	2,494
Repurchase agreements	289	-	-	-	-	289
Payables on financial derivative transactions	36	4	2	18	-	60
Financial liabilities held for trading	7	-	-	-	-	7
Financial liabilities at fair value through profit or loss	-	20	-	-	-	20
Amounts due to customers	8,865	6,063	7,667	2,753	591	25,939
Other borrowed funds	48	126	508	6,173	308	7,163
Total undiscounted financial liabilities	**10,175**	**6,300**	**9,654**	**8,944**	**899**	**35,972**

	GROUP 2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Amounts due to other banks	713	68	903	686	-	2,370
Payables on financial derivative transactions	5	1	3	11	-	20
Amounts due to customers	6,970	4,952	7,604	2,094	519	22,139
Other borrowed funds	56	89	418	6,354	258	7,175
Subordinated debt	-	6	-	74	624	704
Total undiscounted financial liabilities	**7,744**	**5,116**	**8,928**	**9,219**	**1,401**	**32,408**

	BANK 2006					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
FINANCIAL LIABILITIES						
Amounts due to other banks	714	68	902	686	-	2,370
Payables on financial derivative transactions	5	1	3	11	-	20
Amounts due to customers	6,971	4,952	7,604	2,094	519	22,140
Other borrowed funds	54	88	420	6,207	258	7,027
Subordinated debt	-	6	-	74	624	704
Total undiscounted financial liabilities	**7,744**	**5,115**	**8,929**	**9,072**	**1,401**	**32,261**

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

The table below shows the remaining contractual expiry by maturity of the Bank's and the Group's contingent liabilities and commitments.

	GROUP AND BANK					
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
2007						
Contingent liabilities	130	401	807	280	138	1,756
Commitments	1,540	178	519	99	-	2,336
Total	1,670	579	1,326	379	138	4,092
2006						
Contingent liabilities	204	294	717	252	142	1,609
Commitments	1,237	120	817	398	-	2,572
Total	1,441	414	1,534	650	142	4,181

41.4. Market risk

Market risks represent the potential effects which external variables have on the asset, liability and off-balance sheet position values of the Bank which are caused by price fluctuations, i.e. financial market fluctuations, and as such include:
- Interest rate risk
- Foreign exchange risk
- Securities risk

Measurement and control of the exposure as well as the limits set up are defined by internal acts, policies and manuals from the Risk Management Department. Control of the exposure to market risks is being performed by the Risk Management Department through its VaR limit system, as well as through a sensitivity limits system (PVBP, FX Delta and Equity Delta).

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

41.4.1. Market risk - trading

Value at Risk

Value at Risk (VaR) is the maximum expected loss, which is not exceeded during a defined period with a certain probability. For the purpose of the VaR calculation, the Bank is using the one-day, 99% historical VaR method. Historical VaR is methodologically simple. For the computation of the VaR with this method, a time series is needed for each market parameter in the portfolio and it is assumed that past rate changes represent a good approximation of future changes.

The following risk factors are taken into consideration: interest rate, currency, commodity, price and volatility. Furthermore, the Bank has VaR limits individually for money market, fixed income and foreign currency business as well as for the total trading book.

VaR figures, in total and per risk factor for the Trading Book, are as follows:

2007	Interest rate	Currency	Effects of correlation	Total VaR
year end	5	4	(2)	7
average	4	1	(1)	4
high	8	4	(4)	8
low	1	-	-	1

2006.	Interest rate	Currency	Effects of correlation	Total VaR
year end	1	1	(1)	1
average	2	1	(1)	2
high	7	2	(2)	7
low	1	-	-	1

Apart from the aforementioned VaR calculations, the Bank is also using a sensitivity analysis in accordance with its portfolio structure, namely PVBP, FX Delta and Equity Delta.

PVBP (Price Value of a Basis Point) shows the sensitivity that the portfolio has on the change in the interest rate, namely a portfolio value change when the yield curve shifts by 1 basis point. For the purpose of monitoring this type of exposure, the Bank has PVBP limits individually for money market, fixed income and foreign currency business.

FX Delta shows the delta exposure of the Bank (spot plus delta position in options) for various currencies. The Bank has FX Delta limits set in place on the total FX position as well as individually for significant currencies.

Equity Delta represents the total open position of the trading book of the Bank in equities and equity derivatives. The Bank has set in place a limit system per share and for the total trading book.

41.4.2 Market risk - non trading

Legal restrictions

The key legal ratio related to the FX position of the Bank is the Croatian National Bank Decision on the limitation of the Bank's exposure to foreign exchange risk by which the Bank is liable to adjust its total open FX position in a way that the position (increased by the position in gold) does not exceed 20% of the total capital, according to the Croatian National Bank regulations.

2007	without options	with options
year end	0.63%	1.39%
average	2.73%	2.59%
high	16.99%	15.16%
low	0.27%	0.24%

2006	without options	with options
year end	2.73%	1.72%
average	4.28%	4.46%
high	12.05%	11.11%
low	0.66%	0.96%

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Interest rate risk management

Interest rate risk management includes implementation of measures and decisions with the aim of minimizing potential negative influences on the balance sheet items caused by changes in interest rates (with a short-term horizon). Besides that, the Bank is analyzing the interest rate changes influence on the market value of equity (long-term horizon).

Net interest income simulation refers to the simulation of the net interest income of the Bank in the case of parallel and nonparallel shifts in interest rates by +/- 100 and 200 basis points (bp). This simulation is conducted for the Bank's total position, and for all major currencies (EUR, CHF, HRK and USD). Prior to 2007, the Bank did not prepare such analyses.

Net interest income simulation for the year 2008 based on data as at 31 December 2007:

	EUR	CHF	HRK	USD	TOTAL
immediate parallel shock plus 200 bp	(89.4)	(69.1)	31.7	(0.8)	(127.6)
immediate parallel shock plus 100 bp	(44.6)	(34.6)	15.9	(0.8)	(64.1)
immediate parallel shock minus 100 bp	53.0	35.6	(16.1)	2.1	74.6
immediate parallel shock minus 200 bp	110.3	71.9	(25.5)	4.0	160.7

Position analysis is made for all major currencies, in the way that all assets and liabilities (balance sheet and off-balance sheet ones) are separated according to the type of interest rates. For this report, all asset and liabilities items are separated, depending on the stipulated interest rate, as follows:
- Items with money market interest rates,
- Items with fixed interest rates,
- Items with administrative interest rates.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

Bank's market value of equity (MVE) report is the basic report on the Bank's long-term exposure to interest rate risk. It is based on the approximate market value of assets and liabilities, and therefore the approximated market value of equity. In this case, the aim of the analysis is to follow the Basel II limit or the influence of 200 basis points shocks on the market value of equity.

The structure of 2% shocks effects of MVE as at 31 December 2007:

	EUR	CHF	HRK	USD	TOTAL
Up to 1 year	(26.6)	8.2	37.2	0.6	19.4
1-5 years	(106.6)	(9.0)	(8.2)	(0.4)	(124.2)
5-10 years	35.2	(4.6)	(18.4)	15.6	27.8
Over 10 years	(1.8)	(14.8)	0.4	0.0	(16.2)
Total	**(99.8)**	**(20.2)**	**11.0**	**15.8**	**(93.2)**

The structure of 2% shocks effects of MVE as at 31 December 2006:

	EUR	CHF	HRK	USD	TOTAL
Up to 1 year	4.2	4.2	(4.2)	(9.8)	(5.6)
1-5 years	(22.4)	4.2	(4.2)	(5.6)	(28.0)
5-10 years	(33.4)	1.4	(8.4)	0.0	(40.4)
Over 10 years	2.8	15.4	0.0	1.4	19.6
Total	**(48.8)**	**25.2**	**(16.8)**	**(14.0)**	**(54.4)**

The analysis shows that the Bank does not have substantial exposure to interest rate risk and the market value risk is well within the Basel II limit.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

41. RISK MANAGEMENT (CONTINUED)

41.5. Operational risk

Operational risk includes the risk of unexpected direct or indirect loss resulting from inadequate or failed internal processes, people, system failures and external events.

The definition of operational risk includes legal risk, but excludes strategic and reputation risk.

Since the operational risk definition is very broad, loss data events need to be categorised and connected to the relevant information. In this way, more focused operational risk management is possible.

Operational risk events are classified into three categories, which are:
- Loss event type
- Business line unit
- Business line function

To ensure consistent identification and classification of operational risk events in accordance with Basel II guidelines, the Bank collected groups of primary and secondary loss event types. All operational risk loss events are classified according to the first level cause of loss and further broken down to the second and third levels.

Reasons for loss event type classification:
- Establishing priority events and necessary actions
- Improved possibility of analysing risk
- Enables standardised database design
- Harmonisation with Basel II guidelines and EU Directives

Operational risk events are collected into a unique database, using the ORCA application.

Basel II guidelines enable institutions to use several risk assessment and risk identification tools. The Bank uses tools such as Risk Mapping, Risk Assessment and Key Risk Indicators.

Under Basel II guidelines and EU directives, there are 3 methods to measure operational risk:
- Basic Indicator Approach
- The Standardised Approach
- the Advanced Measurement Approach.

The Bank decided to use the Advanced Measurement Approach starting in 2009.

Insurance

Under the Operational Risk Insurance Program, the Bank is insured against classical risk and specific banking risks.

Classical risk includes property damage, burglaries, robberies, vandalism (valuable assets risk) and general liability. Specific risk includes internal and external frauds and technology risks.

The operational risk insurance program is also an operational risk mitigation measure.

Managing operational risk

Within the operational risk framework the Bank has adopted, there is an Operational risk Policy describing how operational risk is managed. The policy contains a ‘check list’ used for the prevention of operational risk events while implementing new Bank products and services. Other operational risk mitigation/control activities include regular risk mapping workshops (conducted annually for the identification of existing operational risk in the Bank), a BCM (business continuity management) project under which the Bank will adopt BCM plans for identified critical activities, self-assessment workshops undertaken during outsourcing projects, and continuous monitoring and reporting of operational risk events. The Bank is planning the introduction of key risk indicators which would, together with above-mentioned conducted activities, represent an overall operational risk framework.

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

42. CAPITAL

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the rules and ratios established by the Croatian National Bank.
During the past year, the Bank has complied in full with all its externally imposed capital requirements.

Capital management

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise value for shareholders.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividends paid to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

Regulatory capital

	Actual 2007	Required capital 2007	Actual 2006	Required capital 2006
Tier 1 capital	3,619	1,520	2,620	1,317
Tier 2 capital	150	1,520	944	1,315
Deduction according to Section 2.4 Croatian Banking Act	(30)	-	(51)	-
Total Capital	**3,739**	**3,040**	**3,513**	**2,632**
Risk weighted assets	29,942	29,942	26,100	26,100
Position, Foreign Exchange, Settlement and Counterparty Risks	448	448	230	230
Total Risks	**30,390**	**30,390**	**26,330**	**26,330**
Tier 1capital Ratio	11.9%	5.0%	9.9%	5.0%
Total capital Ratio	12.3%	10.0%	13.3%	10.0%

Notes to the financial statements

YEAR ENDED 31 DECEMBER 2007 (ALL AMOUNTS ARE EXPRESSED IN HRK MILLION)

42. CAPITAL (CONTINUED)

Regulatory capital consists of Tier 1 capital, which comprises share capital, share premium, retained earnings including non-distributable current year profit, capital gains and other reserves. The other component of regulatory capital is Tier 2 capital which includes Portfolio Provisions up to 0,5 percent of total risk weighted assets for 2007 (1 percent for 2006).

43. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were signed and authorised for issue on 24 January 2008.

These financial statements were approved by the Management Board on 24 January 2008.

Signed on behalf of the Management Board:

Petar Radaković	Slađana Jagar
President of the Management Board	Member of the Management Board